Hong Kong's Competitive Edge -
Partnership in Business Ethics

Toolkit on Directors' Ethics

Hong Kong Business Ethics Development Centre

ICAC
Independent Commission Against Corruption, Hong Kong

Addendum

Corruption Prevention Services for the Private Sector

Please note that with effect from 10 September 2026, the Corruption Prevention Advisory Service (CPAS) and the Hong Kong Business Ethics Development Centre (HKBEDC) of the Independent Commission Against Corruption (ICAC) have been restructured as the Private Sector Integrity Centre (PSIC).

Accordingly, any references to the CPAS and HKBEDC in this publication are to be read as referring to the PSIC from that date onwards.

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Private Sector Integrity Centre
Independent Commission Against Corruption
10 September 2026

廉政公署 ICAC

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The Hong Kong Business Ethics Development Centre of the Independent Commission Against Corruption (ICAC) (details of the Centre are set out in Section A of Part 5) is much indebted to the following organisations for their invaluable contributions and opinions made towards the production of this Toolkit:

Government Departments / Regulatory Bodies

- Companies Registry
- Official Receiver's Office
- Hong Kong Exchanges and Clearing Limited
- Securities and Futures Commission

Professional Bodies

- Hong Kong Institute of Certified Public Accountants
- The Hong Kong Institute of Chartered Secretaries
- The Hong Kong Institute of Directors
- The Law Society of Hong Kong

Chambers of Commerce

- Federation of Hong Kong Industries
- The American Chamber of Commerce in Hong Kong
- The Chinese General Chamber of Commerce
- The Chinese Manufacturers' Association of Hong Kong
- The Hong Kong Chinese Enterprises Association
- The Hong Kong General Chamber of Commerce

Abbreviations

CO	Companies Ordinance (Cap. 622)
C(WUMP)O	Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32)
GEM	Growth Enterprise Market
ICAC	Independent Commission Against Corruption
INED	Independent non-executive director
IPO	Initial public offering
POBO	Prevention of Bribery Ordinance (Cap. 201)
SFC	Securities and Futures Commission
SFO	Securities and Futures Ordinance (Cap. 571)
the Exchange	The Stock Exchange of Hong Kong Limited

From the Editor

This Toolkit provides general guidance for educational purpose only and does not purport to deal with all possible issues that may arise in any given situation. Explanations of the legal requirements under the relevant Ordinances are necessarily general and abbreviated from the layman's angle. If in doubt, users of this Toolkit should seek legal advice as and when necessary. Neither the Independent Commission Against Corruption (ICAC), nor the contributing government departments, regulators, organisations, societies, associations and chambers of commerce, accept any liability, legal or otherwise, for loss occasioned to any person acting or refraining from action as a result of any material in this Toolkit.

Users of this Toolkit are also reminded that the corporate governance framework of Hong Kong is evolving. Legislations, rules, regulations and codes governing company directors' duties and the corporate governance of a company might be updated from time to time. As such, users are encouraged to check the websites of respective regulators and authorities regularly to keep abreast of the latest development.

Some of the case studies and scenarios provided in this Toolkit are adapted from past ICAC cases but the names of the persons, companies and enterprises involved are all fictitious. They are for illustration only and any similarity is entirely coincidental.

Throughout this Toolkit, the male pronoun is used to cover references to both the male and female. No gender preference is intended.

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Part 1

INTRODUCTION

Part 1

INTRODUCTION

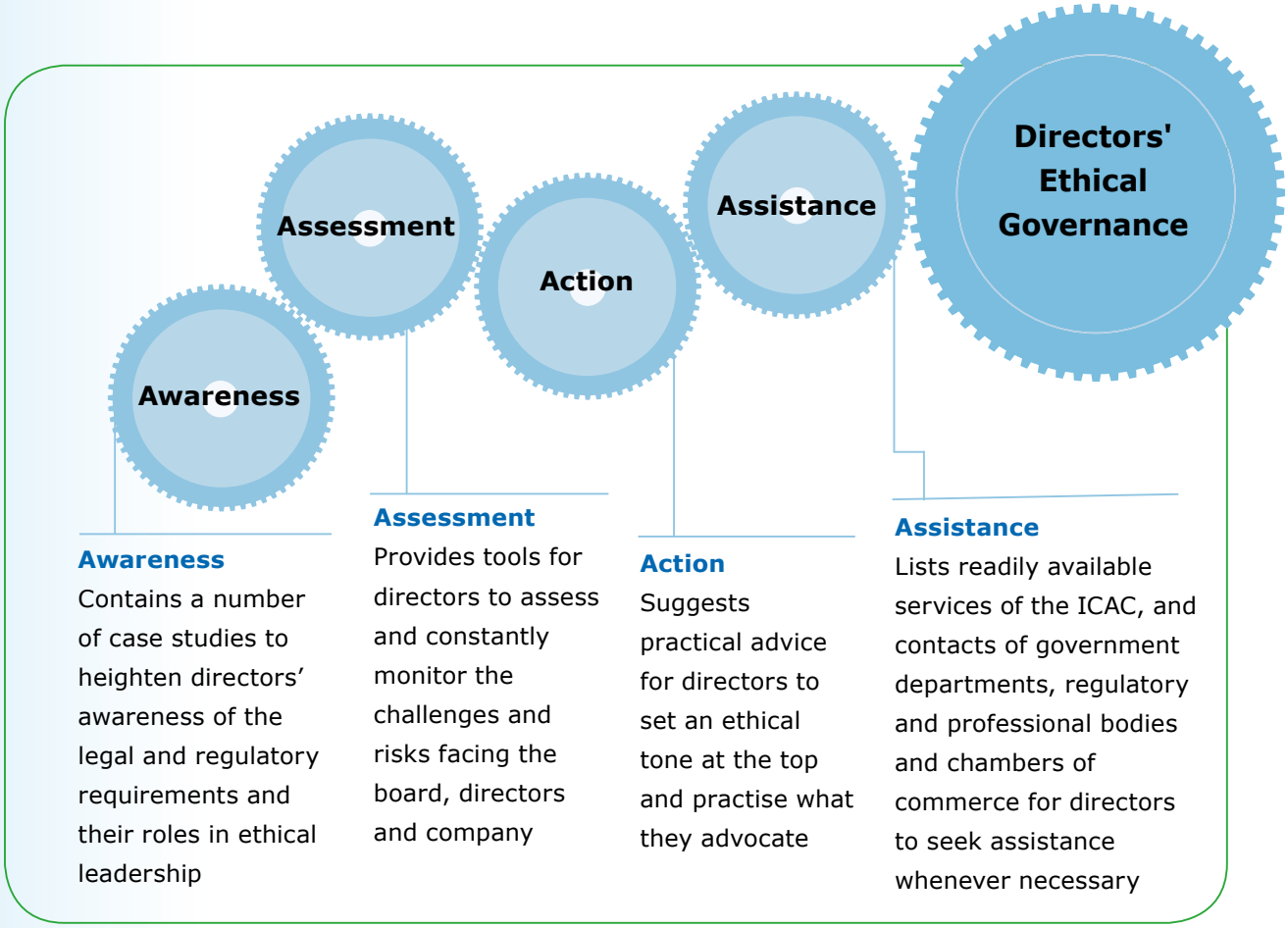
No one would deny the value good corporate governance creates for a corporation. To manifest this notion, company directors are expected to play a pivotal role in ensuring sustainable business growth and protecting the interests of shareholders especially in difficult times or when ethical challenges arise. While the board of directors is collectively responsible for the management and strategic development of the company, each director, whether executive or non-executive, should fulfil his fiduciary duties by exercising his powers and contributing to the board and / or committees on which he serves with skill and expertise up to the standard objectively demanded of a person in his position, as heightened by his subjective skill sets. It is also of fundamental importance for all directors to uphold the highest standard of personal integrity.

Some directors may at times neglect their basic roles and responsibilities in practising good governance to safeguard the reputation and interests of their corporations. In some extreme cases, corporate leaders and professionals are even found to be the masterminds of corporate corruption, fraud and other malpractices, compromising their ethical standard and business values for their own personal gain and benefit. Because of these issues, we produce this Toolkit and outline three key elements to help directors master the evolving ethical challenges and take on effective leadership roles in setting the appropriate ethical tone for their boardrooms and corporations. The three key elements are:

- First – embrace personal ethics to steer their corporation ahead in an ethical manner;
- Second – assess ethics-related risks and challenges facing the corporation through constant monitoring and supervision; and
- Third – take action to cultivate an ethical board and corporate culture to turn ethical challenges into opportunities.

This Toolkit puts forward a "4As" model, namely **Awareness**, **Assessment**, **Action** and **Assistance**, to assist company directors to perform their ethical leadership role successfully.

"4As" Model to enhance directors' ethical governance



Under this "4As" model, this Toolkit is designed with the following features:

- Provides a list of ordinances, regulations and guidelines on the role of directors enforced or issued by various government departments, regulatory and professional bodies;
- Provides relevant website addresses for access to the original text of the above;
- Uses case studies to illustrate situations where corruption, fraud or malpractice are encountered by company directors and how they fell short in assessing the risks in the boardroom and workplace;
- Contains ready-made, user-friendly practical tools for directors' reference and application, such as ethics checklist and sample corporate code of conduct; and
- Proposes a step-by-step model to facilitate directors in handling ethical dilemmas or governance risks.

How to use this Toolkit?

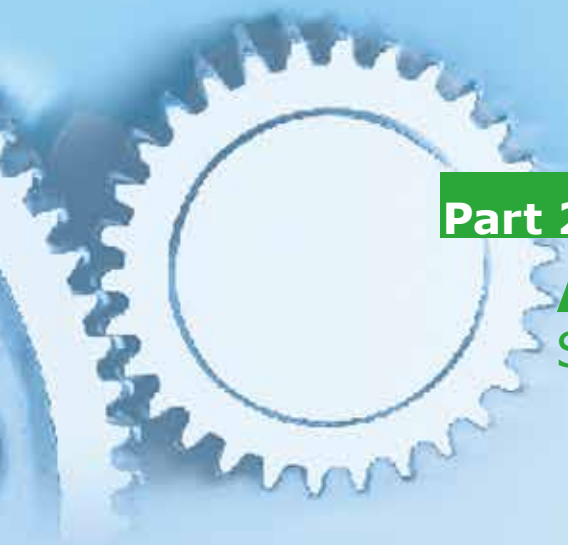
For quick and easy reference, you will find the following icons throughout the Toolkit. They serve to lead you to the information you want:

Legislation – explanation of relevant ordinances, such as the Prevention of Bribery Ordinance, Companies Ordinance, Theft Ordinance, Securities and Futures Ordinance

Guideline – elaboration on the Listing Rules and other related guidelines issued by regulators for company directors, such as A Guide on Directors' Duties

Tool – provision of practical tools to enhance company directors' awareness of their role and facilitate their discharge of different monitoring duties

Pointer – cross references with other parts of the Toolkit, including the annexes



Part 2

AWARENESS

Staying Alert

Part 2

AWARENESS
Staying Alert

The role of a board of directors is to serve as the helmsman of a corporation, guiding the development of the corporation strategically and steering it towards success. Throughout this process, the board members may encounter different challenges and risks associated with corruption, fraud, malpractice or unethical behaviour which would erode business success and tarnish the corporation's reputation in the long run. To master these ethical challenges, company directors should practise ethical leadership, implement and maintain strong governance practices and uphold personal integrity.

However, a number of past cases in Hong Kong have shown that some company directors failed to recognise their pivotal role as ethical leaders and guardians of their company's interests. Some of the directors were negligent with respect to legal and regulatory requirements while others actively perpetrated corruption and related fraud plots. The following case studies can best illustrate such shortcomings. They demonstrate six major areas of concern as listed below and each will also outline particular sections of an ordinance, rules, regulations and guidelines:

Areas of Concern	Case Study
Accepting Advantages	Case 2.1 (Page 10)
Offering Advantages	Case 2.2 (Page 15)
Fabricating Documents	Case 2.3 (Page 18)
Conspiracy to Exaggerate Company's Performance	Case 2.4 (Page 21)
Misuse of Inside Information	Case 2.5 (Page 24)
Conflicts of Interest	Case 2.6 (Page 29)

Section A Case Studies in Focus

Case 2.1 – Missing unanimous permission and proper documentation

Accepting Advantages

Martin was one of the four directors and shareholders in a company trading in different types of chemical products. In his position, he could make all the procurement and purchasing decisions. Roy, sales director of a chemical colourings supplier, was eager to secure business amidst keen competition. As such, he reached secret deals with a number of clients including Martin. Regarding it as a normal trade practice to accept rebates, Martin consequentially accepted $30,000 as a reward for placing orders for textile dyestuffs and colourings with Roy's company. The case was finally brought to the attention of the ICAC and tried at court. Yet, the story did not end there.

Martin argued in court that two other directors gave him retrospective permission to accept the rebates. He claimed the rebates were compensation for his payment for gifts and entertainment expenses to the company's customers as a way to facilitate business. He argued that this was a customary practice. When Martin was asked under what circumstances the permission was granted, he could only recall they gave him permission while travelling on a business trip and no written record was made. However, the third director who was invited to testify at court, said he had never been informed of such an arrangement and even if he had learnt of it, he would not have agreed with their deal. Did Martin have legitimate approval to accept the rebates? Would he be convicted in the end?

Issues of Concern:

Legal Perspectives

- Under Section 9 of the Prevention of Bribery Ordinance (Cap. 201) (POBO), Martin as an agent should obtain his principal's permission before accepting an advantage; otherwise he should apply for permission as soon as reasonably possible after the acceptance. Martin was regarded as an agent as he was only one of the directors of the company while the company served as his principal. Martin definitely did

not have the company's consent as at least the third director was unaware of such an arrangement.

- Martin regarded it as a normal trade practice to accept the rebates but this was not a defence for accepting advantages under Section 19 of the POBO. The two directors also justified the rebates as a compensation for Martin's payment of "grease money" to the company's customers. Even though he argued the rebates served to compensate what he offered as a customary practice, the court would not consider the other two directors' retrospective permission as substantiated as this is illegal under Section 9 of the POBO. The two directors just consented to Martin's acceptance of rebates loosely without going through proper procedures and maintaining proper record. [1]
- Martin was eventually convicted and sentenced to six months' imprisonment.

[1] Prevention of Bribery Ordinance (Cap. 201) (POBO)

- POBO is enforced by the ICAC to deal with corruption crimes in both private and public sectors. Section 9 of the POBO maintains fair play in the private sector and upholds market integrity.
- Section 9(1) of the POBO prohibits the solicitation and acceptance of advantage by an agent in connection with his principal's business. The key points of the section are highlighted below for easy reference.

Key Points	• any agent (e.g. an employee, including a director) • without the permission of his principal (e.g. the employer, the company) or any reasonable excuse • solicits or accepts any advantage* • for doing or forbearing to do any act in relation to his principal's affairs or business • shall be guilty of an offence
Penalty	• a maximum fine of HK$500,000 and an imprisonment of 7 years

* Advantage refers to anything that is of value such as money, gift, commission, loan, employment, service or favour, except entertainment. Entertainment refers to the provision of food or drink for consumption on the occasion when it is provided, and any other entertainment connected with such provisions.

- Section 19 of the POBO states that profession / trade or customary practice is not a defence for offering or accepting any advantage. The court shall make the judgement based on whether the principal's permission is given.
- In addition, Section 9(5) of the POBO specifies that the permission should be given before the advantage is accepted or as soon as reasonably possible after such acceptance. In any case, the principal should, before giving such permission, pay regard to the circumstances in which it is sought.

- For details, please go to the ICAC website at:
  www.icac.org.hk/en/law/law/index.html
  Annex 1 *Extracts of the relevant sections*

Role and Power

- Company directors should uphold personal integrity and strive to cultivate an ethical corporate culture. However, Martin could not resist the corrupt offer and accepted the illegal advantages. The other two directors even tried to abuse their power by justifying Martin's acceptance of the rebates as compensation for his corrupt payments to the company's clients. They failed to recognise the serious consequences caused, including: setting a bad example for their subordinates, jeopardising fair competition among their suppliers, prompting Roy's company to inflate their charges to compensate for the rebates to Martin and thereby adding cost to their own company and tarnishing the company's goodwill. In the long run, corrupt practices can also adversely affect the level-playing field of the city. Therefore, company directors should not condone unethical and illegal behaviours in their companies.
- Company directors should ensure that rules and guidelines are put in place by the management to govern the acceptance of advantages by directors themselves and staff at all levels. They should also direct the management to conduct business, including cross-boundary business, in strict compliance with local laws and the company's code of ethics.

Guidelines

- Apart from the law, company directors should comply with relevant regulations and guidelines in performing their duties. For example, they should act for proper

purpose according to the Listing Rules issued by The Stock Exchange of Hong Kong Limited (Listing Rules).[1] In accordance with A Guide on Directors' Duties issued by the Companies Registry [2], they also have a duty not to abuse their position to accept personal benefit (Principle 9).

[1] **Listing Rules, The Stock Exchange of Hong Kong Limited (the Exchange)**

- Listing Rules* govern the listing of securities on the Exchange. Rule 3.08 lays down that the Exchange expects listed company directors to fulfil fiduciary duties and duties of skill, care and diligence to a standard at least commensurate with the standard established by Hong Kong law. That means every director must, in the performance of his duties:
  (a) Act honestly and in good faith in the interests of the company as a whole;
  (b) Act for proper purpose;
  (c) Be answerable to the issuer for the application or misapplication of its assets;
  (d) Avoid actual and potential conflicts of interest and duty;
  (e) Disclose fully and fairly his interests in contracts with the issuer; and
  (f) Apply such degree of skill, care and diligence as may reasonably be expected of a person of his knowledge and experience and holding his office within the issuer.

* *The Listing Rules mentioned in this Toolkit is mainly referring to the Main Board Listing Rules. For companies listed on the Growth Enterprise Market (GEM) of the Exchange, they can refer to the equivalent sections of the GEM Listing Rules.*

- Rule 13.09(1) requires listed companies to disclose, as soon as reasonably practicable, any information which is necessary to avoid the establishment of a false market in their securities. If a listed company believes that there is likely to be a false market in its listed securities, it must contact the Exchange as soon as reasonably practicable.

- The Main Board and GEM Listing Rules can be downloaded from:
  www.hkex.com.hk/eng/rulesreg/listrules/rulesandguidelines.htm

2 A Guide on Directors' Duties, Companies Registry

- In general, the responsibilities and liabilities of directors derive from various sources, including the constitution of the company, case law and statute law. If a person does not comply with his duties as a director, he may be liable to civil or criminal proceedings and may be disqualified from acting as a director. Although case law sets out and elaborates on most of these significant principles, it tends to be complex and inaccessible. A Guide on Directors' Duties issued by the Companies Registry outlines the general principles for a director in the performance of his functions and exercise of his powers.

- The Guide lays down 11 general principles of directors' duties as follows:

  Principle 1: Duty to act in good faith for the benefit of the company as a whole

  Principle 2: Duty to use powers for a proper purpose for the benefit of members as a whole

  Principle 3: Duty not to delegate powers except with proper authorisation and duty to exercise independent judgement

  Principle 4: Duty to exercise care, skill and diligence

  Principle 5: Duty to avoid conflicts between personal interests and interests of the company

  Principle 6: Duty not to enter into transactions in which the directors have an interest except in compliance with the requirements of the law

  Principle 7: Duty not to gain advantage from use of position as a director

  Principle 8: Duty not to make unauthorised use of company's property or information

  Principle 9: Duty not to accept personal benefit from third parties conferred because of position as a director

  Principle 10: Duty to observe the company's constitution and resolutions

  Principle 11: Duty to keep accounting records

- The Guide can be downloaded from:
  www.cr.gov.hk/en/companies_ordinance/docs/Guide_DirDuties-e.pdf

Case 2.2 – Health company offering unhealthy commissions

Offering Advantages

Good Health Company was a long-established company which specialised in selling high-end Chinese medicines, dried seafood and health products. A few years after it was listed on the Exchange, Arnold's company acquired control of Good Health and he became the company's new Chairman. With an aggressive expansion plan along with huge advertising expenses, Arnold opened more than 10 retail stores within a short period of time. However, its rapid expansion, hard hit by a sharp rise in rental rates and the cost of products, prompted Arnold to find new ways to increase the company's profit.

Tourists from Asia and the Mainland constituted a significant share of Good Health's clientele. To boost sales, Arnold conspired with the Chief Executive Officer and Business Promotion General Manager to offer commissions to the directors of three travel agencies personally. In return for the commissions, they would arrange inbound tours to visit Good Health retail stores. The commissions were equivalent to 20% of the total amount spent in the shops by the respective tour groups. It was hoped that the commissions offered would help bring in more business for Good Health.

Knowing Arnold was keen to generate greater sales volume, the travel agencies' directors later pushed him to increase the commissions to 30%, which in turn ate into Good Health's bottom line. This vicious cycle, coupled with the ever increasing rental costs, drove Arnold to order products of lower quality and even fake medicines.

Months later, a newspaper reported on Good Health's allegedly unethical practices based on a customer's complaint. What impact would this cause on Good Health and Arnold?

Issues of Concern:

Legal Perspectives

- Under Section 9 of the POBO, both the offer and acceptance of bribes constitute an offence. Since the directors of the three travel agencies are only agents, the secret commissions without their principals' approval were illegal advantages. Therefore, Arnold and the other management personnel who offered the commissions committed bribery, too. [2]

- Their corruption scheme was finally unveiled. Arnold and all the related parties were convicted and sentenced to imprisonment ranging from one to three years. It is necessary to be aware of the business partners' policy on acceptance of advantages and their principals' permission while conducting businesses.
- Arnold and his management team might also breach the Trade Descriptions Ordinance (Cap. 362) for selling fake medicines. [3]

[2] **Prevention of Bribery Ordinance (Cap. 201) (POBO)**

- Section 9(2) of the POBO states that any person, without the permission of the agent's principal, offers any advantage to an agent as an inducement to or reward for the agent's doing or forbearing to do any act in relation to the affairs or business of the agent's principal commits an offence.

- Further details can be found at:

www.icac.org.hk/en/law/law/index.html

Annex 1 *Extracts of the relevant sections*

[3] **Trade Descriptions Ordinance (Cap. 362)**

- Under Section 7 of the Ordinance, any person who supplies goods with a false trade description commits an offence.

- Details of the Ordinance can be accessed through the Hong Kong e-Legislation at:

www.elegislation.gov.hk

Role and Power

- As Good Health's Chairman, Arnold is responsible for both the financial performance of the company and managing the company in the best interests of the shareholders and stakeholders. However, Arnold was so preoccupied with achieving deep profits for the company that he compromised his own integrity and the long-term development of Good Health. His decision to purchase low quality and even fake medicinal products in order to recoup the bribery cost eventually brought forth customer complaints. Good Health's reputation built up over many years was severely tarnished. The share price eventually dropped drastically.

Investors suffered losses while the public's confidence in its stock and products plummeted. Their acts of bribery even triggered the directors of the travel agencies to demand more, resulting in an increase of the company's financial burdens.

- As the new Chairman, Arnold was responsible for cultivating the right corporate culture focused on integrity, good corporate governance and compliance with legal and regulatory requirements. His ambition caused him to fail in performing his role as Good Health's Chairman.

Guidelines

- Failing to perform the ethical leadership role mentioned above, Arnold had acted against the Listing Rules and A Guide on Directors' Duties which requires directors to act for proper purpose (Principle 2) and to act in good faith in the interests of the company as a whole (Principle 1). 1&2 page 13-14

Case 2.3 – Procuring company funds through false documents

Fabricating Documents

Matthew was the Executive Director of Smart Toys, a listed company that manufactures and sells plastic toys. Matthew was also the owner of another trading firm which had recently run into financial difficulties. He began to explore different means to alleviate his financial problem.

Knowing that Smart Toys only hired a few logistics companies to provide transportation services to overseas clients without calling for quotations, Matthew instructed the shipping unit head to cooperate with him in a well-plotted scheme. Matthew first set up a shell company claiming to arrange transportation services for Smart Toys. The shipping unit head then informed the genuine logistics companies that Matthew's shell company was Smart Toys' associated company and all payments would be made in its name hereafter. Under this scheme, the shell company issued false invoices to Smart Toys purportedly showing that transportation services were provided at charges 30% higher than the actual cost. Matthew's shell company would then pay the genuine logistics companies and pocket the difference which amounted to over $7.5 million in just one year.

A year later, the board of directors of Smart Toys decided to strengthen its corporate governance framework and put in place more comprehensive internal controls. Could Matthew's scheme keep going?

Issues of Concern:

Legal Perspectives

- Matthew, as an agent of his company, breached Section 9(3) of the POBO by intentionally using false documents, namely the bogus invoices, to deceive and mislead his principal, i.e. Smart Toys. [4]
- Although the shipping unit head was under Matthew's instruction to prepare and process the bogus invoices, he was liable to prosecution under conspiracy to deceive Smart Toys.
- The corruption scam was finally unveiled by the internal auditor and referred to the ICAC for investigation. Matthew and the shipping unit head were both convicted and imprisoned. Matthew's trading firm eventually went bankrupt.

[4] Prevention of Bribery Ordinance (Cap. 201) (POBO)

- Section 9(3) of the POBO states that it is an offence if an agent intends to deceive his principal by using any false or erroneous or defective receipts, accounts or other documents.

- For details, please go to the ICAC website at :

  www.icac.org.hk/en/law/law/index.html

Annex 1 *Extracts of the relevant sections*

Role and Power

- Matthew managed his own financial problem through abusing his senior position in Smart Toys illegally, resulting in huge losses to the listed company. Instead of installing and strengthening internal systems of control in the company to guard against illegal activities and malpractices, such as selecting suppliers from an approved list, specifying the circumstances for purchasing goods by quotations, conducting random checks on the quotations, segregating duties to minimize opportunities for corrupt collusion, he chose to break these rules for his own personal gain. Maintaining a high standard of integrity remains the fundamental role a company director should fulfil.

Guidelines

- Matthew failed to act in accordance with Rule 3.08 of the Listing Rules and A Guide on Directors' Duties to act in good faith for the benefit of the company as a whole (Principle 1), not to gain advantage from his position as a director (Principle 7) and avoid conflicts between his personal interests and those of the company (Principle 5). [1&2] page 13-14
- Moreover, the dealings between Smart Toys and the shell company set up by Matthew are connected transactions and therefore subject to the requirements set out in the Listing Rules. [1] page 13
- Good system control enables the early detection of corrupt and fraudulent practices. The Corporate Governance Code and Corporate Governance Report of the Listing Rules requires the board of a listed company to ensure that appropriate and effective risk management and internal control systems are established and maintained by the company. [3] *C.2, Corporate Governance Code and Corporate Governance Report, Appendix 14 of the Listing Rules*

3 Corporate Governance Code and Corporate Governance Report, Appendix 14 of the Listing Rules, The Stock Exchange of Hong Kong Limited (the Exchange)

- Corporate Governance Code and Corporate Governance Report is appended to the Listing Rules. 1 page 13
- The Code sets out the principles of good corporate governance and two levels of recommendations: (a) code provisions; and (b) recommended best practices. Listed companies are expected to comply with, but may choose to deviate from, the code provisions. In case of deviation from any code provision, the listed company must explain to its shareholders why good corporate governance is achieved by means other than strict compliance with it. The recommended best practices are laid down to provide guidance for listed companies.

- The document can be downloaded from the following website:

www.hkex.com.hk/eng/rulesreg/listrules/mbrules/documents/appendix_14.pdf

Case 2.4 – Corruption scam scuppering listing dream

Conspiracy to Exaggerate Company's Performance

Ten years ago, Ken established On Lung Household, a manufacturer of domestic appliances. As Chairman of the company, Ken was ambitious and aimed to expand his business and list On Lung. He conspired with the Vice-chairman, director and accountant of On Lung as well as the Chairman and director of its associated company, Fu Wing, to conduct an intricate scam.

Fu Wing's Chairman and director first submitted bogus transaction records to defraud a number of banks in applications of letters of credit. Over thirty letters of credit were issued to Fu Wing to purchase plastic appliances from On Lung in order to create a picture of active on-going business for On Lung. Ken then worked with other conspirators in the company to falsify sales invoices and accounting records so as to inflate the turnover and profits of On Lung for the past few financial years. They further presented the falsified financial position of On Lung for those financial years in its initial public offering (IPO) prospectus in order to qualify for listing on the Exchange.

As a result of the fraudulent scam, a number of banks released payments to On Lung under the letters of credit. On Lung then reverted a portion of the funds to Fu Wing.

This was a win-win scheme for both companies, or was it not?

Issues of Concern:

Legal Perspectives

- Corruption can lead to other serious criminal offences such as conspiracy to defraud. In this case study, Ken conspired with his own managerial staff as well as the Chairman and director of another company to deceive a number of banks when obtaining letters of credit and the Exchange for being listed. Their conspiracy scam eventually collapsed as the ICAC soon commenced investigation. Ken and all the co-conspirators were convicted of the common law offence of conspiracy to defraud. They were also disqualified from serving as company directors as under the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) (C(WUMP)O), a person can be disqualified from acting as a director for a specified period under a court order if he is convicted of an indictable offence which involves fraud or dishonesty. [5]

- On Lung also contravened the Securities and Futures Ordinance (Cap. 571) (SFO) by disclosing materially false or misleading information in the company's IPO prospectus which induced investors to subscribe for and purchase its shares, as well as employing a fraudulent or deceptive scheme in relation to its listing in Hong Kong. [6]

[5] Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) (C(WUMP)O)

- Under Section 168E of the C(WUMP)O, a person can be disqualified from acting as a director for up to 15 years under a court order if he is convicted of an indictable offence which involves fraud or dishonesty. According to the Fifteenth Schedule of the same Ordinance, a person is considered unfit for being a director if he commits any misfeasance or breaches any fiduciary or other duty in relation to a company.

- Details of the Ordinance can be accessed through the Hong Kong e-Legislation at:

www.elegislation.gov.hk

[6] Securities and Futures Ordinance (Cap. 571) (SFO)

- To ensure orderly securities and futures market operations, the Securities and Futures Commission (SFC) as a regulator enforces the SFO to guard against market misconducts, including disclosure of false or misleading information inducing transactions.
- Sections 277 and 298 of the SFO prohibit the distribution of materially false or misleading information that is likely to induce another person to subscribe for or buy securities.

- Details of the Ordinance can be accessed through the Hong Kong e-Legislation at:

www.elegislation.gov.hk

Role and Power

- All company directors should uphold a high standard of personal ethics. Otherwise, they can simply bypass all governance mechanisms. Furthermore, company directors are responsible for enhancing their staff members' alertness to corruption temptations and understanding of the laws. Despite this, Ken neglected his role and induced his staff to become conspirators in order to fulfil his listing dream. He had misused his power and put his long-established business at huge risk in doing so. After the scam was unveiled, On Lung's share price fell sharply and was eventually delisted and wound up. Investors and shareholders suffered catastrophic losses while creditors were also adversely affected. Not only will he face criminal liability for breaches of the POBO and SFO, Ken also undermined the integrity of the listing system of the Exchange.

Guidelines

- The above grave consequences on On Lung and the shareholders demonstrated clearly that Ken and the directors concerned had failed their fiduciary duties to act in the best interest of the company. They had also failed to take reasonable steps to secure that the company keeps accounting records that are sufficient to disclose with reasonable accuracy the company's financial position and financial performance as stated in Principle 11 of A Guide on Directors' Duties. [2] page 14

Case 2.5 – Insider disrupting fair market

Misuse of Inside Information

Vincent was the Chairman of a public listed semi-conductors manufacturing company. Three years after listing on the Exchange, Vincent expanded his business by acquiring three other electronics and technology companies and consolidated them into one big group. Due to rapid technological change, Vincent soon discovered he made a poor strategic decision as he lacked sufficient understanding of the new industries he had entered into through his recent acquisitions. This, coupled with the over-expansion, gradually brought financial problems to the whole group. Its profits were weaker than expected.

To raise capital, the board of directors announced a spin-off listing of the group on the New York Stock Exchange. The proposal was finally called off due to the group's continuous poor financial performance. Vincent, who was personally tied up with heavy mortgages on several properties, sought hard to ease his burden. He knew the company would be announcing publicly the current financial position indicating a heavy loss of $250 million and the cancellation of the spin-off listing proposal. The company's share price would no doubt fall sharply afterwards.

Eventually, through the assistance of the company's Chief Executive Officer, Vincent sold around 15 million of the company's shares, which he had bought in the names of his three close friends with three securities firms so as to circumvent the laws and regulations governing securities transactions by directors. He further procured his wife to sell 80 million shares of the company. Vincent succeeded in doing all of this before the announcement of the company's financial standing was disclosed to the public.

Issues of Concern:

Legal Perspectives

- Under the SFO, Vincent committed an insider dealing offence because he took advantage of the information available to him as Chairman, namely the company's deteriorating financial position and cancellation of the spin-off listing proposal which were about to make public, to sell shares before the public announcement in order to avoid personal losses. He also procured his wife to do so for avoiding further losses. Serving as Vincent's assistant in the plot, the Chief Executive

Officer also engaged in conspiracy of insider trading. At the same time, Vincent breached Part XV of the SFO for failing to disclose his interests in shares in the listed company to the Exchange and the company. [7]

- In addition, the provisions under Part XIVA of SFO impose a general obligation of disclosure of price sensitive, or "inside" information, by listed companies. The company should have announced its poor financial performance when it became aware of problems brought by over-expansion and the new acquisitions. The company should have announced the cancellation of the spin-off listing proposal once it was the subject of a decision by the board. Accordingly, the company failed to disclose inside information in a timely manner. As Chairman of the company, Vincent is also in breach of the law because he intentionally caused a delay in disclosing the information.
- Under the SFO and the Listing Rules, Vincent as Chairman of the company should declare the number of shares he held, including those held for him in the names of others, in the annual report. If Vincent purposely omitted declaring in the annual report those shares held for him by his friends or wife, he might have breached Section 384 of the SFO and Section 21 of the Theft Ordinance (Cap. 210) [8] in providing such false information to deceive members or creditors of his company or be liable to other criminal offences.

[7] **Securities and Futures Ordinance (Cap. 571) (SFO)**

- As defined in SFO, insider dealing is one kind of market misconduct. Basically, insider dealing normally takes place when:
  - A person connected with a listed company, i.e. an insider (e.g. director, staff member or auditor, etc.), possesses privileged information which could affect the share price when disclosed, and trades, or procures other persons to trade in the securities or derivatives of the company so as to make profits or avoid losses before the public are aware of the information; or
  - A person obtains information through another person whom he knows is connected with a listed company, i.e. an insider, and performs the above acts before the public are aware of the information.

  Please refer to Sections 246 to 249, 270 to 273, 286 to 289 and 291 to 294 of the SFO for details.

- Besides, Section 307B under Part XIVA of the SFO states that a listed corporation must, as soon as reasonably practicable after any inside information has come to its knowledge, disclose the information to the public.
- In addition, Part XV of the SFO requires directors of a listed corporation to disclose their interests, and short positions, in any shares in such corporation, and their interests in any debentures of such corporation by notifying the Exchange and the corporation.
- Section 384 of the SFO also prohibits listed companies from giving materially false or misleading information, whether knowingly or recklessly, to the Exchange or the SFC in its shareholding disclosure notices or annual reports.

- Details of the Ordinance can be accessed through the Hong Kong e-Legislation at:

www.elegislation.gov.hk

[8] Theft Ordinance (Cap. 210)

- Section 21 of the Theft Ordinance states that it is an offence if a company director publishes or concurs in publishing a written statement or account which he knows is misleading, false or deceptive with intent to deceive members or creditors of his company.

- Details of the Ordinance can be accessed through the Hong Kong e-Legislation at:

www.elegislation.gov.hk

Role and Power

- In his senior position, Vincent could gain access to different inside information of his company, such as its future development, that may result in a change in share price. As Chairman, he should have set a good example to the management and staff by not making use of the company's confidential information for personal gain. All in all, he should act for the best interest of the company and shareholders as a whole.

Guidelines

- Apart from the SFO, company directors of listed companies should also understand other related regulations and guidelines and be well aware of their liabilities of failure in compliance. For example, they should comply with the Model Code for Securities Transactions by Directors of Listed Issuers [4] issued by the Exchange and follow the Guidelines on Disclosure of Inside Information [5] issued by the SFC. Failure to do so may result in a breach of the relevant regulations.
- In the case study, Vincent failed to observe his duty of not gaining advantage from the use of his position as a director (Principle 7) and not making unauthorised use of company's property or information that he became aware of as a director of the company (Principle 8) as specified in A Guide on Directors' Duties. [2] page 14

[4] Model Code for Securities Transactions by Directors of Listed Issuers, Appendix 10 of the Listing Rules, The Stock Exchange of Hong Kong Limited (the Exchange)

- This Model Code is listed as Appendix 10 of the Listing Rules. The Code sets a required standard against which directors must measure their conduct regarding transactions in securities of their companies. Any breach of such required standard will be regarded as a breach of the Listing Rules. An important part of the Code states that directors who are aware of any price-sensitive information must refrain from dealing in the listed companies' securities until proper disclosure of information. In addition, a director must not make any unauthorised disclosure of confidential information, or make any use of such information for the advantage of himself or others.

- The Model Code can be downloaded from the following website:
www.hkex.com.hk/eng/rulesreg/listrules/mbrules/documents/appendix_10.pdf

5 Guidelines on Disclosure of Inside Information, Securities and Futures Commission (SFC)

- The Guidelines are published by the SFC under Section 399 of the SFO to assist listed companies to comply with their obligations to disclose inside information under Part XIVA of the SFO. The Guidelines provide common examples of circumstances where a listed company should consider if a disclosure obligation arises.

- The Guidelines can be downloaded from the following website:

  www.sfc.hk

Case 2.6 – Conflicts undermining long-established business

Conflicts of Interest

In the late 1980s, James founded Comfort Apparels, a company specialising in the design and manufacturing of casual wears. Since its establishment, the company had experienced phenomenal growth and was listed on the Exchange eight years ago. However, James had become increasingly pessimistic about his business due to the soaring production and operational costs in recent years. His worry was further aggravated by the gradual shrinking of the company's market share in their core product lines. Because of these reasons, James in his capacity as Chairman was proactively looking for potential buyers who could offer a good price for Comfort Apparels. He could then retire earlier.

In a gala dinner organised by a manufacturers' association, James met Owen, the Chief Executive Officer of a large sports apparel company which was listed on the New York Stock Exchange with a chain of retail stores in the United States. In subsequent meetings, Owen expressed his company's interest to acquire Comfort Apparels, including its manufacturing plant and facilities in the Mainland, to facilitate their development plan in Hong Kong and the Mainland. However, Comfort Apparels should show a 20% increase in its gross margins within the financial year. Eager to reach the deal, Owen even offered a certain number of his company's shares to James once the takeover succeeded. James was very attracted by the offer and he instructed his sales director and operations director to explore whatever means to achieve the target. They were assured of an attractive year-end bonus if the deal was completed successfully.

As a result, the two trusted lieutenants tried various methods to boost the sales volume and reduce the production costs, including loosening the credit policy and purchasing lower quality fabrics. With the deadline drawing near and the target still far-off, they offered kickbacks to their clients' merchandisers and quality controllers as rewards for placing extra orders and accepting low quality products.

James was not aware of the above secret offers made by his sales director and operations director. Neither did he know that before Owen approached him, Owen's company paid a consultancy firm in Hong Kong a handsome fee for updated information on Comfort Apparels' business situation, details of the facilities and production capacity of its manufacturing plant in the Mainland and the possibility

of a takeover. This consultancy firm was in fact owned by Elisa, Comfort Apparels' Executive Director, who had not told any board members of Comfort Apparels about this consulting work.

Issues of Concern:

Legal Perspectives

- In the case study, both James and Elisa have encountered a conflict of interest situation. James, as Chairman, should handle Owen's takeover plan in the best interest of the company and its shareholders. However, he was influenced by the offer of shares in Owen's company upon a successful takeover. Similarly, Elisa facilitated Owen's takeover plan by agreeing to provide him with the consulting work on Comfort Apparels. She had obviously placed herself in a situation where her own private interests conflicted with the interests of Comfort Apparels.
- It is also important to note that the mishandling of conflicts of interest will, in the worst case, lead to an offence under the POBO. For example, there was a strong case to hold Elisa liable under Section 9 of the POBO as she, as an agent, accepted Owen's paid consulting work for providing updated information of Comfort Apparels' business situation which was related to her principal's affairs. [1] page 11

Role and Power

- As Chairman, James should have guided his company towards success with observance of the law, good governance and offered sound direction to the management whenever required. Instead, ambitious to secure the takeover and with his personal interests in mind, James simply set an unrealistic target to his subordinates without comprehending their difficulties or advising them on any concrete direction. As a consequence, they loosened credit policies and used lower quality fabrics that would increase Comfort Apparels' financial risks, affect the quality and brand name of its products and damage its long-established goodwill. In the end, tempted by a potential year-end bonus, they even offered illegal rebates to accomplish the task. Company directors should be well aware of the grave consequences their decisions would impose on their companies, their staff and all the related stakeholders.

Guidelines

- As company directors, both James and Elisa owed fiduciary duties to Comfort Apparels. According to the Listing Rules, they should avoid actual and potential conflicts of interest. [1] page 13 A Guide on Directors' Duties, under Principle 5, also points out clearly that directors must not allow personal interests to conflict with the company's interests and, under Principle 7, must not use his position as a director to gain any advantage for himself, or someone else, or which causes detriment to the company. [2] page 14
- According to The Codes on Takeovers and Mergers and Share Buy-backs administered by the SFC [6], an independent committee should be set up under the board to discuss and make a recommendation to shareholders about the takeover. James should also disclose the financial remuneration he would receive if the takeover succeeded to the board of directors and shareholders.

[6] **The Codes on Takeovers and Mergers and Share Buy-backs, Securities and Futures Commission (SFC)**

- The Codes are issued by the SFC. Their primary purpose is to afford fair treatment for shareholders who are affected by takeovers, mergers and share buy-backs. The Codes require equality of treatment of shareholders through mandating disclosure of timely and adequate information for shareholders to make an informed decision as to the merits of an offer. The Codes also provide an orderly framework within which takeovers, mergers and share buy-backs are to be conducted by ensuring there is a fair and informed market in the shares of companies affected by such activities.

- The Codes can be downloaded from the following website:

  www.sfc.hk

Section B What Went Wrong and Lessons to Learn

The above case studies share some common characteristics. One feature is the directors' insufficient awareness of their roles in practising ethical governance. The worst case scenarios have occurred when those empowered to enhance ethical governance in the company are instead the orchestrators of illegal acts who would face criminal sanctions. In brief, some important points-to-note are as follows:

Not observing legal obligations

- Most of the characters in the case studies disregarded their own legal obligations or interpreted the law in their own ways. It is important that they have adequate understanding of and respect for the relevant legislations, regulatory guidelines and codes of ethics regulating their actions as well as a clear understanding of the serious consequences of breaking the laws or regulations. Apart from criminal liability, a person may be disqualified from acting as a director for a specified period under a court order if he is convicted of an indictable offence which involves fraud or dishonesty according to the C(WUMP)O. [5] page 22 The Listing Rules also require every director of a listed company to fulfil his fiduciary duties, and apply such degree of skill, care and diligence as may reasonable be expected of a person of his knowledge and experience and holding his office within the company. [1] page 13 A director should refer to the dual objective and subjective tests set out in the Companies Ordinance (CO) when deciding whether there is any breach of his duty of care, skill and diligence as a director. [9]

9 **Companies Ordinance (Cap. 622) (CO)**

- Every officer of a Hong Kong–incorporated company, including its director(s), has the responsibility to ensure that the company has complied with all the provisions of CO. If a company fails to comply with the requirements of the Ordinance, the company and every officer shall be liable to prosecution and, if convicted, default fines apply.
- Section 465 of the CO also requires a director to exercise reasonable care, skill and diligence, which means the care, skill and diligence that would be exercised by a reasonably diligent person with:
  - the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company (known as the "objective test"); and
  - the general knowledge, skill and experience that the director has (known as the "subjective test").

- Details of the Ordinance can be accessed through the Hong Kong e-Legislation at:

www.elegislation.gov.hk

Great temptations and low personal ethical standard

- As leaders of the company, directors wield abundant power and authority particularly concerning decision-making for strategic development, restructuring, deployment of resources, merger and acquisition plans, etc., all of which can influence the company's share price to a certain extent. As such, they are at high risk of succumbing to temptations and abusing their powers for personal gain.
- As shown in the case studies, the culprits were driven by desires to secure more businesses, achieve expansion, cut corners to quickly obtain the listing status, sell the company for a good price and mastermind corruption and fraud plots for personal gain. Overseas academics specialised in the subject of corporate culture, such as Professor Stewart HAMILTON and Ms. Alicia MICKLETHWAIT, classified top executives' *"greed, hubris and a desire for power"* as one of the six major factors leading to corporate failure.[1] An ineffective board of directors is another factor.

[1] In the book *"Greed and Corporate Failure – The lessons from recent disasters"*, Professor Stewart HAMILTON and Ms. Alicia MICKLETHWAIT grouped the main causes of a spate of corporate failures into six categories: poor strategic decisions; overexpansion and ill-judged acquisitions; dominant CEOs; greed, hubris and the desire for power; failure of internal controls at all levels from the top downwards; and ineffectual or ineffective boards.

As they pointed out, *"People tend to be naturally greedy, rarely content with what they have achieved. High achievers, such as top executives, are particularly ambitious and eager for more power and wealth."* The board of directors should install strong governance mechanisms and be on extra alert of the conduct of its top executives. Effective checks and balances must be in place to prevent these executives from acquiring extra power and wealth illegally or unethically. Besides conforming to policies and systems of control, having a strong personal integrity is of utmost importance. All in all, the board of directors should closely monitor if all executives embrace personal ethics and perform in the best interests of the company as a whole.

Insufficient understanding of a director's role

- Company directors are generally aware of their role in directing the strategic development and sustainable growth of their corporations. However, as shown in the case studies and some local and overseas cases, some directors are unaware of their important monitoring role over management's performance to protect the interests of different stakeholders, especially shareholders. They further underestimate the importance of investing sufficient time and energy to understand the company's business, performance, risks encountered and extent of their power in the effective discharge of their monitoring role. Certain directors rubber-stamped decisions while others were simply clueless as their own management stole company assets. An effective company director should study the documents prepared by the management carefully, ask critical questions and demand explanations whenever in need, to prevent any illicit operations.
- To enhance company directors' awareness of their important role, a self-questioning tool [1] is prepared to help them assess if they are ready to accept the directorship and fulfil their duties effectively after entering the boardroom. Company directors should also refer to the Corporate Governance Code and Corporate Governance Report included in the Listing Rules, which provides for the adoption of specific responsibilities for directors. [3] page 20 *A.6, Corporate Governance Code and Corporate Governance Report, Appendix 14 of the Listing Rules*
- Directors may also refer to the Guidelines for Directors [2] published by the Hong Kong Institute of Directors for more information on what functions and duties that a company director is required to perform.

Professionals' failure as the corporate guardians

- Professionals, such as auditors, lawyers and chartered secretaries, provide valuable services as advisors to company directors and as guardians watching out for malpractices, non-compliance with regulatory requirements and illegal acts committed by officers in the company. However, there have been cases where some professionals have neglected their guardian role and even conspired with company directors for their own personal gain. As in most of the cases, the masterminds could not succeed without the assistance of their senior executives or professional advisors. Company directors should identify the strengths of their professional advisors and depend on their support to facilitate the sound performance of their duties and responsibilities.

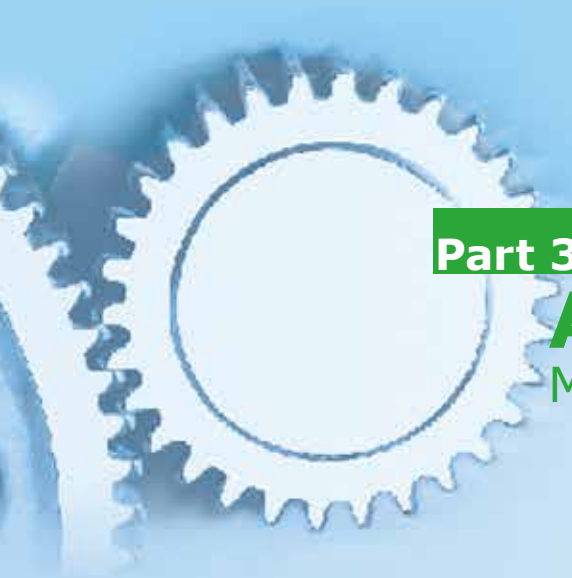
1 Ethics Checklist for Company Directors

Annex 2 *A full copy*

2 Guidelines for Directors, The Hong Kong Institute of Directors

- The publication is a reference book assisting both practising and newly appointed directors in fulfilling their duties. Issues addressed in it include the functions of directors, how the board operates, as well as directors' legal status, powers and duties.

- The Guidelines can be downloaded from the following website:
  www.hkiod.com/guidelines-for-directors.html



Part 3

ASSESSMENT

Mitigating the Risks

Part 3

ASSESSMENT
Mitigating the Risks

To drive a corporation towards perpetual success, strong awareness of one's role, power, related laws and regulations are only some of the critical factors. Company directors should constantly monitor their business operations to anticipate and mitigate risks encountered, particularly where corruption and fraud may arise. On one hand, directors should continuously identify and assess the evolving challenges and risks facing their boards, fellow directors and management. On the other hand, they should monitor regularly whether the management discharges their duties ethically and if appropriate and effective risk management and internal control systems are in place to safeguard the interests of the company and shareholders as a whole.

However, some corporate failures show lapses by some company directors in monitoring their board members and management effectively. These failures ultimately affect different stakeholders. The following case studies illustrate their shortcomings, which can be broadly classified into five categories in terms of the nature of the schemes and the participants involved:

Nature of the Scheme	Case Study
Investment related Ethical Challenges	Case 3.1 (Page 38) Case 3.2 (Page 41) Case 3.4 (Page 48)
Collusion among Management	Case 3.2 (Page 41) Case 3.3 (Page 45)
Conspiracy among Employees	Case 3.5 (Page 51) Case 3.6 (Page 55)
Undesirable Association with Suppliers / Contractors	Case 3.5 (Page 51)
Secret Dealings with Clients	Case 3.6 (Page 55) Case 3.7 (Page 59)

Case 3.1 – Collusion with financial professionals

Investment related Ethical Challenges

Alan was the Chairman of Well Time, a public listed company engaged in the design, manufacture and distribution of timepieces. As founder of the company, which developed from a small factory to the present enterprise, Alan had been keen not only on maintaining the business but also on expanding it to attain an attractive share price. He contacted two financial experts for help who offered their "hard to resist" proposals.

First, a senior director of an investment bank proposed to assist in boosting Well Time's share price. Alan was asked to place some 20 million Well Time shares with an exercise price of $1.5 each. The bank's senior director then strongly recommended the stock to his clients by exaggerating claims of its future development and offering incentives to influence their purchases. Noting a growth in the share price, eventually more investors were drawn in and the share price were further pushed up. When the price reached a particular level, Alan sold the shares for personal gain. The bank's director demanded $500,000 as a reward for his assistance in the scheme.

Second, Alan knew very well the impact an analyst's report published in the media would have on a particular stock. Hence, he approached a securities analyst of a brokerage firm to discuss how to publicise Well Time's shares. The analyst offered to write a "buy" oriented report of Well Time's shares to boost their value in the public's eye. In return, $200,000 should be paid as his "writing fees".

Eager to achieve his goal, Alan acceded to both requests. No irregularities had been observed by the board of directors. The company's shares eventually soared to nearly five times of the original value.

Issues of Concern:

Risks identified

- Bribing financial professionals, such as bank executives and analysts, to influence the share price through price rigging or writing exaggerated / misleading reports.

Consequences

- The booming picture resulted from the fabrication could not last long. The case was finally brought to light. The trio were convicted and sentenced to jail terms ranging from two to three years.

Practical tips to mitigate risks

Exercising due diligence

- In the case study, the price rigging scheme and the preparation of the exaggerated report were solely conducted by the Chairman with external parties. Had the executive directors and management exercised due diligence in the daily operation of the company, such as closely observing any irregular share price and share allotment movements, tracing for the influencing factors and reviewing the validity of analysts' reports, the scam might have been unveiled earlier.
- Non-executive directors and independent non-executive directors (INEDs) are not involved in the day-to-day operation of the company. These directors mostly rely on the information provided or the formal presentations made by the management to make judgement. However, they should stay observant of the company's development and cultivate an inquisitive mind to question management whenever in need.
- In fact, listed companies must provide timely disclosure of information necessary to avoid a false market in accordance with the Listing Rules. [1] page 13 To maintain a fair and orderly market, the Exchange will, as a normal practice, contact a listed company if it notices unusual movements in the price or trading volume of its securities, or press reports or market rumours which may affect the price or trading volume of its securities. The responsible member (company secretary in most cases) then usually consults each director on the factors leading to the unusual movements. Nonetheless, where internal procedures are already in place

to ensure that the responsible officer is fully informed, this may not be necessary. If appropriate, a statement authorised by the board will be issued on whether they are aware of any matter or development contributing to the unusual trend. As such, it is important for company directors and INEDs in particular to keep abreast of the company's development, such as any investment made, and to monitor its stock performance. A query by the Exchange will ring a bell to them to enhance their awareness in this aspect.

- To strengthen their monitoring role, INEDs may request relevant information and data from the management sufficient for them to make decisions. For example, in the case study, audit committee members could generate a list of specific questions to go through with management to ensure they have addressed the issue in question and taken appropriate action. [3]
- To enhance INEDs' understanding on the company's performance, executive directors and management should circulate monthly management reports or updates, showing items such as budgets, forecasts, monthly financial statements, summary of connected party transactions and any other information pertinent to all board members (including INEDs) for information. [3] page 20 *C.1.2, Corporate Governance Code and Corporate Governance Report, Appendix 14 of the Listing Rules* This also serves to raise the transparency of daily management.

[3] **Suggested questions for audit committee members to go through with the management:**

- Are there any appropriate and effective risk management and internal control systems in place to guard against corrupt and fraudulent practices in the company?
- Have you observed any irregularities in the company's stock price?
- If so, have you found out the reasons affecting the above?
- If the reasons are abnormal, have you taken appropriate action to address the irregularities?
- Have you provided the board / audit committee with a summary of findings and actions taken?
- Have you studied the recent analysts' report(s) of the company? Did you observe any exaggeration or misleading statements in the report(s)?
- If so, have you found out the reasons affecting the above?
- Have you observed any abnormal change in accounting figures, for example:
  - any significant growth in profit and revenue?
  - any significant reduction in operating expenses?
  - any significant change in non-recurring income or expenses?

Case 3.2 – Conspiracy in masking company performance

Investment related Ethical Challenges and Collusion among Management

Quick Solutions, a computer parts trading company, expanded swiftly a few years ago by engaging in domestic and commercial IT projects in the Mainland. Under the chairmanship of Frederick, it was also listed on the Exchange. The rapid expansion had strained the company's financial situation to a certain extent. Soon after it was listed, Frederick was eager to explore "solutions" to raise its share price quickly in order to attract more investors and international funds.

What "solutions" could Frederick try? His Executive Director proposed a scheme. They instructed the company's financial controller, who was also the company secretary, to doctor the company's accounting and business records to show a profit of some $40 million was made in the year. To do this they had to inflate the company's profit four-fold. The financial controller and company secretary knew very well that the board members would not challenge the financial documents as they were preoccupied with their own corporate affairs or serving directorships of other companies. The financial controller and company secretary worked with two other staff members to fabricate bogus documents purporting to be accounting and business records of the company and submitted them to an auditing firm for auditing. Subsequently, a Report of the Auditors was released and shareholders were led to believe that the company had performed well, with a net profit of over $40 million.

Quick Solutions' share price surged afterwards. How long could this last and what would happen to Frederick and his accomplices?

Issues of Concern:

Risks identified

- Chairman and management colluded to fabricate financial documents to deceive external auditor, putting the interests of shareholders and even the public at risk.

Consequences

- Frederick could not enjoy the surging share price for long. An accountant, who was forced to join the scam but did not want to be manipulated endlessly, reported the case to the ICAC eventually. Those involved were all convicted under various charges of conspiracy to defraud and conspiracy to use false documents. They were sentenced to imprisonment ranging from three and a half years to four years and were disqualified as company directors for the same period as their jail terms. Quick Solutions was eventually delisted.

Practical tips to mitigate risks

Setting up audit committee with competent members

- In accordance with the Listing Rules 3.21 and 3.22, every listed company must establish an audit committee with clear terms of reference. The audit committee must comprise non-executive directors only. With a minimum of three members, the committee must at least include one INED with appropriate professional qualifications or accounting or related financial management expertise so that they are competent to comprehend and raise questions on related financial reports and documents to monitor their integrity. Readers can refer to the Corporate Governance Code and Corporate Governance Report for the terms of reference of audit committee. [3] page 20 *C.3.3, Corporate Governance Code and Corporate Governance Report, Appendix 14 of the Listing Rules* Some important aspects to ensure effective functioning of the audit committee are as follows:
  - Members have to invest sufficient time and energy to study the meeting papers and discuss the issues thoroughly in meetings. In case of doubt, they can make further queries with the management, the company secretary, internal auditor, chief financial officer or other related parties any time between meetings for clarification. If necessary, they can seek professional advice to address their concerns.
  - To exercise due diligence, audit committee members can put forward specific questions to ensure management's proper handling of the critical issues. [4]
- Readers may also refer to A Guide on Better Corporate Governance Disclosure [5] published by the Hong Kong Institute of Certified Public Accountants for guidance on making meaningful disclosure about the effectiveness of the audit committee to their companies' stakeholders.

Effective monitoring of external auditor's performance

- The auditing firm in the case study has shown negligence in performance. Noting the significant changes in Quick Solutions' accounting figures, it simply issued the auditing report without pursuing the company to provide the reasons with supporting documents. The auditor should modify the opinion in the auditor's report when he concludes that the financial statements as a whole are not free from material misstatement; or if he is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.
- As the audit committee serves as a link between the board and external auditor, committee members should communicate with external auditors regularly, ensure unusual items identified by external auditors are properly followed up and critically assess the re-appointment or removal of the auditing firm serving the company.

Independent internal reporting channel

- The Chairman in the case study was found colluding with the Executive Director and other senior management to commit the illegal acts. To some extent, it is not easy for board members to uncover the truth based on the fabricated documents. A more effective way to control the matter is to encourage staff tempted or instructed to join the scam to report. Members of the board should therefore monitor the management to cultivate an ethical corporate culture and formulate a well-protected whistle blowing policy. Staff members at different levels should be encouraged to report their concerns or irregularities encountered to a senior officer, such as the chief compliance officer who reports directly to the audit committee. It is also recommended to establish a mechanism for staff members to lodge report, in confidence, to the audit committee directly. [3] page 20 *C.3.8, Corporate Governance Code and Corporate Governance Report, Appendix 14 of the Listing Rules* These open and well-protected channels of communication will enhance staff members' confidence in reporting.

Segregation of duties

- The combined roles of company secretary and financial controller might pose another risk to the company. Potential conflicts of interest exist as information received in one capacity might be used for another purpose. The board might consider splitting these two roles. In appointing a company secretary, the board of a listed company should, in accordance with the Listing Rules 3.28 [1] page 13 ,

consider the academic and professional qualifications and experience of that individual to ensure that he is capable of taking on the role of company secretary specified in the Corporate Governance Code and Corporate Governance Report. [3] page 20 *F, Corporate Governance Code and Corporate Governance Report, Appendix 14 of the Listing Rules*

[4] Suggested questions for audit committee members to go through with the management:

- Did the Exchange raise any queries with the company recently from __ to __ (please specify a period of time) regarding trading volume, price fluctuation or any other matters?
- Have you followed up the query by providing a reasonable explanation with sufficient supporting documents to the Exchange?
- Have you provided the committee with a summary of the queries and actions taken?
- Have you observed any unusual profits or losses between __ and __ (please specify a period of time)? If so, have you considered recommending disclosure under the SFO? [7] page 25-26
- Have you ascertained these unusual profits will not impose risks on the company, such as increasing its operational risk, accounting risk or any other threat to the company?

[5] A Guide on Better Corporate Governance Disclosure, Hong Kong Institute of Certified Public Accountants

- The Guide is published to encourage meaningful corporate governance disclosures by Hong Kong listed companies, under the revised Corporate Governance Code [3] page 20 of the Listing Rules. It covers four topics: the role of the board, internal controls, audit committee and communications with shareholders.

- The Guide can be downloaded from the following website:
  www.hkicpa.org.hk/en/membership-and-benefits/professional-representation/corporate-governance/publications/gov-publications/cg-practices

Case 3.3 – Falsified documents swindling external auditor

Collusion among Management

Patrick was the Chairman and Chief Executive Officer of a public listed company manufacturing leather goods. Two months after it was listed, Patrick suffered severe losses in the property market and urgently sought funds to repay his debt. Authorised to approve large sums of payment and sign company cheques himself, Patrick stole company funds by issuing seven cheques within a month, totaling some $20 million, drawn on the bank accounts of the company's subsidiary. The cheques were paid to a trading company owned by his cousin who would then pass the amount to Patrick.

To cover up the misappropriation, Patrick produced four false receipts issued by a mainland construction company, purporting to show that some $20 million was received by the construction company as deposit and construction fees for a plant building project in the Mainland. The project was briefly reported in a board meeting. A resolution was also passed to make payments to the construction company through its representative office in Hong Kong, which was in fact the trading firm of Patrick's cousin, for better administrative purpose. Patrick conspired with the internal auditor, who was his brother-in-law, to conceal the truth. He also believed that the external auditor would not pursue the matter seriously as the auditing firm also provided tax planning and IT management consultancy work for the company at the same time charging double the audit work. Besides, the board's audit committee seldom communicated with the auditing firm and they mostly met as a formality to endorse financial reports.

Issues of Concern:

Risks identified

- Fabricating false documents to deceive the board and external auditor to cover up misappropriation of company funds, causing huge losses to the company.

Consequences

- Paper can never cover fire. Owing to the dispute between Patrick and his cousin over the sharing of funds pocketed, the scam was finally unearthed. Both Patrick and his cousin were convicted and imprisoned for six years and three years respectively. Patrick also declared personally bankrupt at the end.

Practical tips to mitigate risks

Ensuring impartiality of auditors

- Both internal and external auditors act as important guardians of the company. In this scenario, employing a family member to be an internal auditor would lead to a potential conflict of interest and weaken the auditor's impartiality and credibility. Members of the board could consider positioning the internal auditor directly under the audit committee which is authorised to assess his performance and even determine his remuneration package to enhance independence and objectivity.
- If the external auditor had failed to apply appropriate safeguard, the threat for him to compromise his objectivity increased when the fee derived from non-audit services was significantly higher than the audit work. Members of an audit committee should formulate a clear policy on the engagement of the external auditor to supply non-audit services. They should also be responsible for reviewing and monitoring the independence and effectiveness of the audit process. [3] page 20 *C.3.3, Corporate Governance Code and Corporate Governance Report, Appendix 14 of the Listing Rules*

Setting up appropriate committee to spearhead major projects

- A corporation may carry out different investment, expansion or related development projects throughout the year. To safeguard the listed company's assets, board members should maintain appopriate and effective risk management and internal control systems. [3] page 20 *C.2, Corporate Governance Code and Corporate Governance Report, Appendix 14 of the Listing Rules* In this case, board members can consider setting up a specific committee, such as an investment committee, to oversee the deployment and control of company asset. The committee can be responsible for evaluating and making recommendations on proposed acquisitions and disposals of assets, expansion plans, approving

budgets, reviewing actual expenses on key expenditures and other investment related activities. Committee members should also possess relevant knowledge and expertise to perform the above tasks. As in the case study, constructing a plant in the Mainland would have involved a large budget requiring discussion and endorsement by board members. If an investment committee had been set up and competent members had diligently raised questions about the project at the meeting, such as the construction status, expenses involved, anticipated increase in production capacity, changes in sales strategy and the possibility to arrange a site visit, this would somehow deter the culprits' unscrupulous acts.

Maintaining proper documentation

- Board members should demand a clear and proper record of board minutes. This can ensure all proceedings and relevant deliberations in reaching a particular decision are properly registered. Unethical scams, not to mention illegal ones, to a certain extent cannot exist under close scrutiny, deliberate discussion, questioning and transparent disclosure to the public. If it was an established practice of the board or its individual committee in the case study to record all decisions with supportive deliberations properly, Patrick could have hardly made up the plant construction project in the Mainland and obtained the related board resolution.

Segregation of duties

- Patrick served as both the Chairman and the Chief Executive Officer. This resulted in an over-concentration of power in one individual, making it difficult to detect and monitor any illegal behaviours or malpractices, especially if that individual is deceptive and has a low ethical standard. Segregation of the two roles can ensure a balance of power and authority. [3] page 20 *A.2, Corporate Governance Code and Corporate Governance Report, Appendix 14 of the Listing Rules*

Case 3.4 – Deceiving banks into granting letters of credit

Investment related Ethical Challenges

Terry, Executive Director of a public listed electronic products manufacturing company, was vexed by the company's recent cash flow problem resulting from his ill-judged investment in setting up production lines in another Asian territory. His brother Alfred, proprietor of two trading companies, was also keen to make some quick money to cover his losses in stock speculations. Alfred proposed working with Terry in obtaining letters of credit from several banks.

Terry was well aware that his company's Chairman, who was fully occupied with different public services, delegated vast powers to him in handling and deciding the company's affairs. The board also comprised a number of his old acquaintances as INEDs who seldom queried his proposal and the financial report. Terry was further assured by Alfred that he was close to some senior bank staff who could facilitate the issue of letters of credit. Hence, Terry finally accepted Alfred's proposal.

The duo prepared some bogus business transactions for Alfred to apply to two banks for 10 letters of credit amounting to some $20 million in favour of Terry's company. Upon receipt, Terry would pass part of the proceeds to Alfred. Both of their cash flow problems seemed to be resolved.

Issues of Concern:

Risks identified

- Conspiring with external parties to furnish bogus business transactions to deceive banks into granting letters of credit.

Consequences

- Facing acute financial needs, Alfred conspired with other companies to deceive the bank into granting letters of credit. The bank's senior management subsequently raised suspicion on the bank staff helping Alfred all along and eventually discovered the scam. The case was referred to the ICAC for investigation. Terry and Alfred were convicted of conspiracy to defraud and sentenced to two to four years' imprisonment. Terry declared bankruptcy eventually. The reputation of Terry's company was also affected and its share price dropped sharply after the case went public.

Practical tips to mitigate risks

Implementing risk management and internal control systems

- To mitigate the risk illustrated in the case study, board members should oversee the listed company's risk management and internal contol systems on an ongoing basis and ensure that a review of the effectiveness of the risk management and internal control systems has been conducted at least annually. [3] page 20 *C.2.1, Corporate Governance Code and Corporate Governance Report, Appendix 14 of the Listing Rules* For example, they could lay down policy requiring the management to seek the board's approval on bank borrowings over a certain amount. To prevent top management from transferring company funds to a conspired party as shown in the case study, a procedure to require all cheques be signed by at least two authorised signatories should be set. An internal auditor should also diligently verify compliance with established procedures and report significant abnormalities to the audit committee.

Balanced board composition

- A board consisting of old acquaintances may, to some extent, share common goals and have smoother cooperation. However, board members may not be willing to raise red flags on possible risks for fear of jeopardising their close relationship. Therefore, companies can review if the board includes a balanced composition of executive directors and non-executive directors to ensure a strong independent element on the board. For a listed company, INEDs must represent at least one-third of its board according to Rule

3.10A of the Listing Rules. [1] page 13 Besides, non-executive directors should be of sufficient caliber and number for their views to carry weight. [3] page 20 *A.3, Corporate Governance Code and Corporate Governance Report, Appendix 14 of the Listing Rules* It is also essential to have a competent and independent audit committee and an effective internal audit team to perform financial audits and internal audits to uncover the truth. Members should also assess if any conflicts of interest exist while making decisions and make declarations whenever appropriate.

Effective chairmanship

- The Chairman of Terry's company failed in taking up a key monitoring role. By delegating too much authority to the Executive Director, he created the obvious risk of relying excessively on one individual who may go undetected when committing illegal acts or get away with unethical conduct if he has low integrity. In any case, the Chairman should provide leadership and take responsibility for ensuring good corporate governance practices and procedures are established. [3] page 20 *A.2.4 and A.2.5, Corporate Governance Code and Corporate Governance Report, Appendix 14 of the Listing Rules* The performance of directors, in particular the Chairman and Chief Executive, can be reviewed regularly by the nomination committee and the remuneration committee to ensure competent persons are in post, re-appointed and receiving remuneration commensurate with their performance. For the recommended duties of the nomination committee [3] page 20 *A.5.2, Corporate Governance Code and Corporate Governance Report, Appendix 14 of the Listing Rules* For the terms of reference of the remuneration committee [3] page 20 *B.1.2, Corporate Governance Code and Corporate Governance Report, Appendix 14 of the Listing Rules*

Case 3.5 – Prolonged corruption cases – Tip of an iceberg?

Conspiracy among Employees and Undesirable Association with Suppliers / Contractors

Fairview Group was a public listed company with diversified businesses covering property development, hotels, resorts and shopping malls. The performance of the hotel business had remained relatively weak compared to the other sectors in the group. The management attributed it to the intense competition of the market.

For some years, Ronald had been the head of engineering department of the hotel group. His plan was to earn great sums of money before his early retirement and emigration to Canada. Being authorised to award decoration, repairing and maintenance contracts for the hotels to contractors, Ronald masterminded a corruption scam. He instructed his subordinates, a chief engineer and an assistant chief engineer, to award over three-fourth of the contracts to two particular building services and engineering companies. They asked the respective company proprietors to inflate all quotations submitted by 10% as a reward for awarding them the contracts. The trio then shared 85% of these additional kickbacks while the contractor could get the remaining 15%.

The scam lasted for five years. Ronald then resigned and left Hong Kong with his post taken up by the chief engineer. Instead of ending the scam, the new department head instructed the contractor to continue the bribe payments. A few months later, the case was brought to the ICAC's attention. The investigation revealed that around $3 million was accepted by the hotels' staff, including Ronald.

Worse still, another corruption scam operating in the hotels was unveiled during the ICAC investigation. The director of the hotels' food and beverage department was found conspiring with the head chefs of several restaurant outlets of the hotels to accept rebates from various seafood and frozen food suppliers as rewards for placing orders with them. A pile of complaint letters by customers on the food quality were kept by the food and beverage director but the matter was never reported at senior management's meetings.

Issues of Concern:

Risks identified

- Staff members conspired to solicit and accept advantages from contractors and suppliers for awarding contracts or purchasing orders to them. Purchasing is regarded as one of the high risk areas for corruption in the workplace.

Consequences

- The masterminds and all co-conspirators in both cases were arrested. Ronald was extradited from Canada to Hong Kong for trial and he received the heaviest penalty of four and a half years' imprisonment. The others' jail terms ranged from two to three and a half years. The hotel group's share price dropped sharply after the case was exposed. The hotel subsequently strengthened various checks and balances measures. Company expenses on decoration projects and food purchases had then shown decrease while more diners were found patronising the hotels' restaurant outlets.

Practical tips to mitigate risks

Cultivating ethical corporate culture

- Corruption risks lie in different functions of the workplace with procurement and awarding contracts being part of the high risk areas. Directors should keep alert to possible corruption-prone areas in different functional areas of the company and closely work with the management in addressing the risks through cultivating an ethical corporate culture. These include:
  - Assessing staff members' awareness of related laws, guidelines and ability to deal with ethical dilemmas;
  - Assessing the sufficiency of internal policies and training in enhancing their awareness of the above; and
  - Assessing the vulnerability inherent in the nature of work within their corporation and the adequacy and effectiveness of risk management and internal control systems in place.

- To strengthen system control for procurement, the Training Package on Corruption Prevention in Procurement can offer practical suggestions. Practical tips on procurement are also suggested in the Best Practice Checklist on Hotel Management and Summary of Corruption Prevention Measures for Catering Industry. 6
- The hotel group's management in the case study definitely failed to build up an ethical corporate culture. Otherwise, the scam might not have operated so systematically and passed on to the "next generation" and lasted for over five years. Corruption also spread to another department and the group's directors finally became victims of their own negligence.
- To help companies quickly assess if they have done enough in building up an ethical corporate culture, such as implementing a corporate ethics programme, the Community Relations Department of the ICAC has produced a health checklist. 7 The basic components of a corporate ethics programme comprise setting one ethical standard for directors and all levels of staff to adhere to, providing training for directors and staff to cultivate their ethical mind and strengthening system controls to plug loopholes for corruption and fraud. The checklist helps diagnose the current position of a company on this corporate ethics tripod.

Monitoring scope and quality of control

- Directors of the board should actively participate in the board's evaluation of whether the management has installed and the company has maintained appropriate and effective risk management and internal control systems. They should also require management to regularly report the results of such evaluation, including any significant failings or weaknesses, at board meetings. 3 page 20 *C.2, Corporate Governance Code and Corporate Governance Report, Appendix 14 of the Listing Rules* They might also formulate a policy requiring discussion and approval of quotations / tenders over a specified amount at a particular committee under the board to exert greater monitoring in this high risk area.

6 Best Practice Checklists

- The Corruption Prevention Department of the ICAC has developed a series of Best Practice Checklists tailored for public and private corporations on how to plug corruption loopholes. Some functional areas and trades covered include:
  - Letting and Administration of Works Contracts
  - Staff Administration
  - Stores Management
  - Procurement
  - Hotel Management

- Check the following Corruption Prevention Advisory Service website for a full list and full copies of the Best Practice Checklists:

  cpas.icac.hk

7 Health Checklist on Corporate Ethics Programme

Please refer to **Annex 3**

Case 3.6 – Cross-boundary operations: New challenge for directors

Conspiracy among Employees and Secret Dealings with Clients

Paul was an INED and an audit committee member of a listed electronic company with a production base in the Mainland. A visit was arranged for a potential client to tour around the plant there to introduce the company's state-of-the-art facilities and its quality control system. Being an old friend of the client's managing director, Paul joined the tour.

Alex, operations manager of the plant posted from Hong Kong, received the group comprising Paul, the client's managing director and his staff members. However, they only spent a few hours in the plant. For the rest of the trip, Alex took the clients on a tour in the vicinity, dining and wining extravagantly and patronising a nightclub. Four expensive watches were also presented to them as "souvenirs".

When Paul was alone with Alex at the plant the next morning, Paul queried Alex on the watches and the extravagant tour as he was concerned about the legality of such an offer. Alex told Paul that he was instructed by the sales director in Hong Kong to treat them well as they were about to place a high-valued purchasing order in Hong Kong. The sales director could not miss this opportunity as the potential order would generate great profits for the company. Alex assured Paul that they had no legal liability as the offer was made outside Hong Kong.

Paul seemed a bit eased. When he walked around the plant by himself, he found some machinery a bit old and only a few workers were present. Paul recalled the quarterly financial reports kept on showing a significant portion of expenses went to maintenance of machinery and hiring of a large number of temporary workers. Paul then asked Alex for an explanation but he just evaded the question and rushed to pick up the clients from the hotel again.

Issues of Concern:

Risks identified

- Making corrupt offer while conducting cross-boundary business resulted from staff's insufficient understanding of anti-corruption laws and absence of risk management and internal control systems for remote operations.

Consequences

- Paul discussed the matter with other audit committee members after he returned to Hong Kong. They authorised the company's chief compliance officer to look into the case. The production director in Hong Kong was found conspiring with Alex in the Mainland to fabricate workers' attendance records and invoices on the maintenance of machinery and then shared the payment while the sales director and his subordinates were found offering rebates for securing some high-valued contracts. The case was reported to the ICAC for handling. All the involved parties were convicted with jail sentences.

Practical tips to mitigate risks

Enhancing understanding of anti-corruption legislation

- Under the POBO, if any part of the act of bribery concerning employees of a Hong Kong company takes place in Hong Kong, it can be pursued under the ordinance enforced by the ICAC. 1&2 pages 11-12 & 16 Even though in this case study, the trip and watches were offered in the Mainland, both Alex and the sales director were liable to prosecution since they used such offer as an inducement to secure the client's purchasing order in Hong Kong.
- Failing to take any action, Paul who joined the trip might easily be perceived as one of the conspirators in offering bribes. Company directors should enhance their understanding of relevant laws and regulations, through obtaining support from the company secretary if necessary, to safeguard themselves from breaching the law inadvertently as ignorance cannot be a defence.

Exercising due diligence

- The poor maintenance of the machinery and the small number of workers present in the mainland factory should ring a bell to Paul that somebody might have falsified documents or conspired in defrauding the company and the board of directors. Paul had set a good example by clinging to his inquisitiveness and following through the matter when he returned to Hong Kong.
- INEDs shoulder the same duties of care and skill and fiduciary duties as executive directors and a common undertaking to the Exchange to procure the listed company's compliance with the Listing Rules. It is important for both executive and non-executive directors to, through participation in continuous professional development, enhance understanding on related laws and regulatory requirements and skills to assess any risks of corruption, fraud and malpractice in order to effectively monitor the company's performance and internal controls. [3] page 20 *A.6, Corporate Governance Code and Corporate Governance Report, Appendix 14 of the Listing Rules* They should also stay competent [1] page 13 *Rule 3.08* and must take an active interest in the company's affairs and follow up anything untoward that comes to their attention.

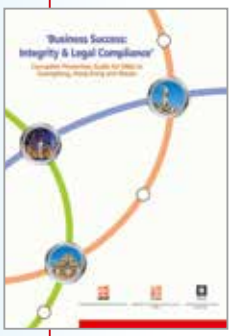
Assessing new risks and implementing effective internal controls

- As a growing number of Hong Kong companies base their operations in the Mainland, company leaders are facing increasing challenges of monitoring operations from afar. This creates even greater challenges for directors of the board, particularly for INEDs like Paul, to ensure the management has taken sound action to address and minimise new types of risks.
- To safeguard interest of the company and the shareholders in the long run, company directors need to assess perpetually through the management whether:
  - fellow board members and staff members understand the legal provisions both in Hong Kong and the Mainland;
  - the company has adopted systems of controls to reduce corruption loopholes as well as measures to enhance cross-boundary supervision; and
  - culture-building programmes have been launched to enhance the ethical standard of staff members working in different locations or jurisdictions. (The ICAC has produced publications to help businessmen and managers conduct cross-boundary business in the Mainland, Hong Kong and Macao. [8])
- Company directors can further strengthen their monitoring role through proactively communicating with staff to collect feedback and understanding the new development of the company's business. They can also inspect the site at times to spot any irregularities and malpractices.

8 Corruption Prevention Publications on Cross-Boundary Businesses

- To help businessmen and managers conduct cross-boundary business in Guangdong, Hong Kong and Macao, the Community Relations Department of the ICAC has produced the following publications for their reference:

"Business Success: Integrity & Legal Compliance" Corruption Prevention Guide for SMEs in Guangdong, Hong Kong and Macao



- Introduces the anti-corruption laws of Guangdong, Hong Kong and Macao with illustrative cases.
- Provides a health checklist for SMEs to assess their effectiveness in controlling corruption risks.
- Illustrates with case studies the management problems of SMEs and offers practical tips on corruption prevention.
- Provides contact information of Guangdong, Hong Kong and Macao governments and relevant support service organisations.

Corruption Prevention Kit on Cross-Boundary Business

- *Ethical Management – Guide for Cross-Boundary Businessmen* – provides reference for Hong Kong businessmen investing in the Mainland through explaining anti-corruption laws of Hong Kong and the Mainland with illustrative cases of cross-boundary corruption and introducing the principles in corruption prevention.
- *Ethical Management – Guide for Managers* – provides reference for managers of Hong Kong companies stationed in the Mainland. Training materials, such as presentations and Q&As on integrity management, are provided.
- *"Unusual Conflict" – Training Package for Business Organisations* – provides a training video and a teaching guide to alert managers of the risks of conflicts of interest and the challenges in managing staff integrity.
- Posters carrying anti-corruption messages are also provided for companies' posting in their mainland premises.

- To obtain the publications, please visit the website of the Hong Kong Business Ethics Development Centre of the ICAC page 84 at:

www.hkbedc.icac.hk

Case 3.7 – Well-protected whistle blower saving company

Secret Dealings with Clients

Tim joined the board of a public listed paper manufacturing company as an INED one year ago. Being an experienced INED serving other listed companies in the past, Tim recommended the paper company to adopt better corporate governance practices. He particularly encouraged the management to provide training for enhancing staff members' understanding of the law and company guidelines, especially on the newly formed whistle blowing policy.

Edward, a sales representative of the paper company, received a call from his client one day enquiring whether she should make payments to his paper company or to another one named Fortune Trading. Edward was puzzled as they had never distributed paper products through this trading company. After further clarification with the client, Edward learnt that his supervisor, Nelson, told the client that the paper products requested were out of stock but he could arrange the purchase through Fortune Trading. Edward conducted searches on Fortune Trading and surprisingly discovered that Nelson was one of the shareholders and directors. He wondered how much of the company's business was lost in this way. Being well assured that all information he provided would be treated carefully and confidentially by the management under the new whistle blowing policy, Edward finally took the courage to report his findings to the compliance manager.

Issues of Concern:

Risks identified

- Diverting customers' orders to self-owned shell company and pocketing the differences. This is a common corruption-prone area in the sales and marketing functions of a company.

Consequences

- The case was eventually referred to the ICAC. Investigation revealed that Nelson

sold the company's paper goods at discounts not normally offered to Fortune Trading which then resold them to clients at an inflated price. This enabled Nelson to make a profit of about $1 million. Nelson was convicted of conspiracy to defraud and using false documents to deceive his company and was sentenced to three years' imprisonment.

Practical tips to mitigate risks

Implementing well-protected whistle blowing policy

- Edward's decision to report his findings to prevent the company from suffering further losses was, to a certain extent, a result of Tim's proposed measures, particularly the whistle blowing policy. A well-protected whistle blowing policy encouraging staff members to report any malpractices or illegal acts to an independent personnel, such as a chief compliance officer who reports directly to the audit committee chaired by an INED, can increase their confidence in speaking up. [3] page 20 *C.3.7 and C.3.8, Corporate Governance Code and Corporate Governance Report, Appendix 14 of the Listing Rule* The remuneration package of the chief compliance officer can be determined by the audit committee based on his performance to further enhance his impartiality.

Implementing risk management and internal control systems

- Sales and marketing functions can also create risks in the workplace. It is essential for directors of the board to supervise the management in establishing and maintaining appropriate and effective risk management and internal control systems to plug the corruption loopholes.

Cultivating an ethical corporate culture

- Rules and internal controls, however, cannot guarantee zero corruption as staff members with low personal integrity will still manipulate the system to make personal gain. It is equally important to assess their ethical standard and build up an integrity corporate culture. This includes encouraging an open exchange between company and employee and their willingness to report malpractices for the sake of the company.
- To achieve greater impact, board members could consider setting up an ethics committee to work with and supervise management regularly to review, formulate and implement the above integrity management measures.

Section B What Went Wrong and Lessons to Learn

The above case studies illustrate how company directors failed in assessing different kinds of risks facing themselves, their fellow board members and the company as a whole. Some crucial points-to-note include:

Undue recognition and monitoring of risks

- As found in some corporate corruption and fraud cases, a number of company directors abused their senior positions and manipulated the loopholes in their corporations to mastermind or conspire in different illegal plots. Some non-executive directors tended to underestimate the corruption and fraud risks facing their companies and failed to monitor the management in addressing the risks. In short, some of the risks commonly encountered by listed companies include:
  - price rigging
  - exaggerated or misleading reports prepared and written by analysts
  - furnishing bogus documents to deceive shareholders, auditors and regulators
  - embezzling corporate funds
  - deceiving banks into granting letters of credit
  - colluding with suppliers and contractors
  - offering / accepting advantages or fabricating staff attendance and accounting records in cross-boundary business

Proposed best practices to strengthen company directors' monitoring role

- To strengthen the monitoring role of company directors, especially for non-executive directors, in recognising and mitigating the above-mentioned risks, the following best practices are suggested:

Due diligence in discharging monitoring duties

- Company directors should invest sufficient time and energy to study the papers submitted by the management, discuss the issues thoroughly at board meetings, request additional information or explanations whenever in need, raise critical questions and put brakes on unclear plans or poor decision-making instead of rubber-stamping decisions. In fact, in most corporations, it is the duty of board members to review and evaluate the strategic options, select the best option

ultimately and oversee its implementation. Throughout this process, it is dangerous to assume or blindly rely on other directors in exercising their own due diligence. Each director should discharge his own monitoring duty independently. Company directors, however, are not alone as they can seek the support of external professional advisors, as well as the company secretary, whenever necessary. In fact, company directors should work closely with company secretaries as they play a significant role in ensuring directors are kept in the information loop regarding their companies' activities and risks.

Possessing relevant caliber and knowledge

- Board members, no matter how diligent or how eminent they are in their own fields, may not possess the relevant industry expertise to raise any questions or alarm on looming corporate and industry risks. As such, on one hand, the chairman and executive directors should ensure balanced board diversity with relevant expertise and avoid any conflicts of interest in the recommendation and appointment of board members. They should also set a limit on the number of directorships an individual director may hold as well as the maximum period one may serve. For example, if an INED serves for more than nine years, any further appointment should be subject to a separate resolution to be approved by shareholders. The board should also set out the reasons why it believes that such an individual continues to be independent in the papers accompanying a resolution to re-elect that individual. [3] page 20 *A.4.3, Corporate Governance Code and Corporate Governance Report , Appendix 14 of the Listing Rules* On the other hand, candidates should analyse if they have the required expertise to add value to the board before accepting the offer as director. They can also request regular update on the company's business and related industrial development from the management and regularly communicate with the management and professional advisors to access any information they need.

Segregation of duties

- Segregating the duties, especially between chairman and chief executive officer, is strongly recommended to avoid concentration of power at the top. According to the 2007 Booz Allen Hamilton survey[2], *"Independent Chairmen are best. Globally,*

[2] The 2007 Booz Allen Hamilton survey was the sixth annual survey conducted and released by the management consultant firm Booz Allen Hamilton in the United States. It studied the 357 CEOs of the world's largest 2,500 publicly traded corporations defined by market capitalisation who left office in 2006, and evaluated both the performance of their companies and the events surrounding their departures.

investors enjoyed the highest returns relative to a broad market average when the Chairman was independent of the CEO, compared to when the CEO also held the title of Chairman, or when the person was the prior CEO."

- This principle also applies to other positions, such as between company secretary and financial controller, to strengthen checks and balances.

Strengthening risk management and internal control systems and setting up relevant committees

- In view of the limited number of board meetings held within a year and the vast scope of items to be discussed, relevant committees, comprising directors with respective expertise, should be set up to monitor different strategies, development and operation of the company. For example, a competent audit committee is indispensable to ensure appropriate and effective risk management and internal control systems are in place to guard against fraud in the company. Investment committee and ethics committee can also be set up to monitor the management in carrying out different investment items properly and implementing effective corporate ethics programme respectively.

Cultivating sensitivity to warning signs

- Achieving sustainable growth, remarkable profits, goodwill as well as sound ethical governance are the ultimate goals for most company directors. However, they should recognise that past corporate success and history do not mean they are protected from corruption, fraud or malpractice. Company directors should remain vigilant and watch for warning signs while studying or discussing the corporation's affairs. Some examples include unusual price movement or trading volume of the company's stock; abnormal changes in accounting figures; report of high-valued investment or procurement items without sufficient briefing or request for decision making of the above hastily with inadequate time and information; and remote operations without strong risk management and internal control systems or frequent monitoring and review by the headquarters amongst other issues. All in all, company directors should constantly stay observant and inquisitive.

Board Evaluation

To ensure effective performance of the board, there are growing discussions on whether it would be possible or even desirable to evaluate the top management of a corporation, especially the board, regularly and systematically. A widely acknowledged report on corporate governance published by the Organisation for Economic Co-operation and Development and many of the codes of conduct for boards that have sprung up in many countries over the last decade recommend such a review. In practice, a number of foreign and local corporations have conducted or commenced to carry out performance evaluation of the board regularly.

Types of evaluation can be broadly classified as:

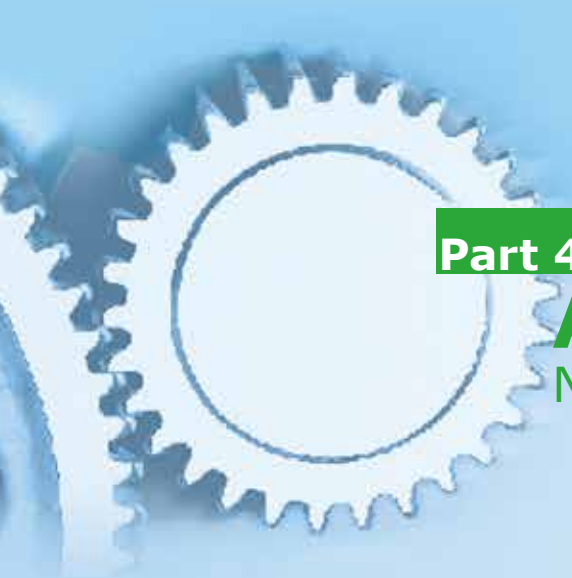
- Evaluation of the board as a group;
- Evaluation of individual board members; and
- Evaluation of the chairman of the board.

It is worthwhile to draw experiences from some foreign companies on how they evaluated the board and fellow members. [9]

After obtaining the evaluation by each board member, it is important to compile the results and discuss them. However, extreme care should be exercised for this last step as discussion involving responsibility and accountability in front of the full board might harden positions on both sides whenever criticism comes up. The board might consider arranging evaluation meetings between the chairman and individual board members separately and confidentially. If the outcome of the evaluation is strongly negative and if there is little promise that improvements will result from the discussions, the termination of board membership may have to be considered. In any case, listed companies in Hong Kong can consider implementing this evaluation process gradually or by phases.

[9] **Sample Performance Evaluation for the Board and Individual Board Members**

Please refer to **Annex 4**



Part 4

ACTION

Navigating the Ethical Course

Part 4

ACTION

Navigating the Ethical Course

Even though company directors are aware of their role, legal and regulatory obligations and diligently assess the risks encountered, an ethical board and corporate culture cannot be achieved and sustained without them taking firm actions. In short, company directors should work within two levels of governance:

- First – personal level. Company directors should be aware of their own personal conduct at the top and practise what they advocate. They should resist all unethical and illegal temptations and speak up to uncover these acts.
- Second – corporate level. Company directors should help the board and their companies promote and build an ethical culture by closely monitoring the management in implementing corporate ethics programme.

Section A Personal Level

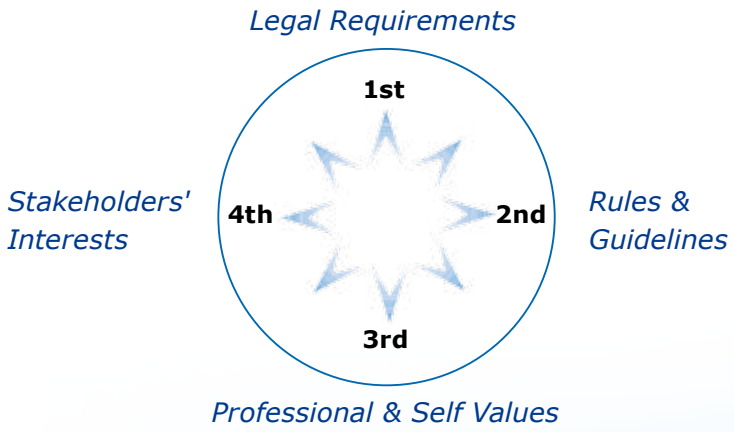
A tree greens from the top while a rotten apple spoils the barrel. Company directors, being strategic decision makers at the top, should serve as a role model for their fellow board members and all staff to follow. They should lead by example and stay vigilant against corruption, fraud, malpractice and other unethical acts. It is equally essential for them to demonstrate the moral courage to speak up and report any illegal acts or irregularities unveiled. Failure to do so will send a wrong message to staff members, investors and the public that the corporation tolerates unethical behaviours. Corruption will breed easily while reputation of the company will be damaged and investors' confidence weakened.

Leadership by example is not always an easy task. Company directors will encounter different risks while navigating their corporations forward, leaving them in ethical dilemmas. To provide company directors with a practical tool, we have developed the **"GPS" Ethics Compass**. [10] This tool gives directors directions in arriving at a sound decision while encountering ethical dilemmas, just as the Global Positioning System shows us the right direction when we get lost.

10 "GPS" Ethics Compass

G

Guide your decision making with each of the four pointers of the following ethics compass before choosing the most appropriate course of action.



P

Perform the guardian role of a company director proactively through:

- assessing the risk level involved in any strategy devised;
- putting brakes on poor strategies or decisions, demanding management's explanations and rectifications; and
- reporting to the board and the relevant authority any unethical concerns, conflicts of interest, malpractices or illegal acts unveiled

S

Sunshine test should always be applied while conducting board and corporate affairs to assess whether the issue can be discussed openly and the decision disclosed without misgivings.

How to use the "GPS" Ethics Compass?

Case Study – Questionable Usage of IPO funds

Keith is a partner in an audit firm. Being a close golf mate with Derek, Chairman of a restaurant group newly listed on the Exchange, Keith was invited by Derek to join the group's board as an INED and further served as the Chairman of its audit committee.

Soon after Keith settled in and started to review the financial report submitted to the committee, he raised a query with the Chief Financial Officer about the proper usage of a fund of $10 million, which was raised through the IPO, and claimed to be spent on property investment. The Chief Financial Officer just briefly explained their investment plan and reiterated that every decision made was discussed with Derek.

Unable to clarify his concerns, Keith had pursued his query several times with Derek who finally admitted he pledged the $10 million to a bank to secure a loan for his wife whose beauty parlour chain, of which Derek is one of the shareholders, ran into financial difficulties. Derek assured Keith that his wife was about to secure a new investor and the loan would be repaid on schedule. He asked Keith to let the matter go as the restaurant group was still financially sound. Derek also reminded Keith that he would be very busy in the months to come as Derek would hire Keith's audit firm to take up the tax and market expansion plan consulting work for the restaurant group.

Keith was left uneasy. He also knew that no information was given to shareholders about the change in the use of the IPO funds as promised in the company's prospectus. To relieve Keith's worries, Derek asked him to relax and get some rest as he had already arranged and paid for all the transportation and accommodation for Keith's overseas golf trip the following week.

Should Keith accede to Derek's request?

By making use of the "GPS" Ethics Compass, Keith can analyse the issue thoroughly in a structured and systematic way through the following steps:

If I were Keith:

Step 1

Guide your decision making with each of the four pointers of the ethics compass before choosing the most appropriate course of action.

Legal Requirements:

- I will violate Section 9 of the POBO if I accept the overseas golf trip as a reward for turning a blind eye to Derek's secret pledge of the company funds. I will breach the same Ordinance if I accept any personal advantages in relation to the award of the non-audit services to my audit firm for not following up on Derek's secret act. [1] page 11
- I will also violate Section 456 of the CO for failing to exercise reasonable care, skill and diligence in carrying out my duties as a director if I willfully cover up Derek's misfeasance. [9] page 33
- Any material change to the use of IPO proceeds is generally price sensitive. If such information was not previously disclosed in the listing document, the company must make an announcement to notify investors of the change after listing. [7] As an INED, I should advise the company to disclose such inside information to the public in order to comply with the disclosure requirement of the SFO. [7] page 25-26

Rules & Guidelines:

- The Listing Rules issued by the Exchange requires a company director to fulfil fiduciary duties and duties of skill, care and diligence to a standard at least commensurate with Hong Kong law. A company director should also act in good faith in the interest of the company as a whole and avoid any actual and potential conflicts of interest. I will fail to comply with these rules if I accept Derek's offer and accede to his request.

- The Corporate Governance Code and Corporate Governance Report 3 page 20 of the Listing Rules lays down provisions about different monitoring responsibilities for company directors. For example, audit committee members should monitor the integrity of the company's financial statements.
- My independence as an INED will be in question if my audit firm, of which I am the partner, takes up the restaurant group's consulting work according to Rule 3.13 of the Listing Rules. 1 page 13

Professional & Self Values:

- I have compromised my integrity, professionalism and accountability to the company if I accept Derek's offer and keep quiet on his pledge of the company funds because:
  - Derek has violated the POBO by offering the golf trip to me as a reward for the above; and 1 page 11
  - Derek has also increased the financial risks of the restaurant group in pledging the company funds secretly for his wife.
- My reputation and trustworthiness will be impaired if I am found covering up Derek's misconduct and failing to perform my fiduciary duties in the best interests of the company. My professional reputation as an auditor will also be tarnished in this way because, as a professional accountant, I have to maintain integrity, objectivity and avoid any action that discredits the profession in accordance with the "Code of Ethics for Professional Accountants" issued by the Hong Kong Institute of Certified Public Accountants. Otherwise, I may face disciplinary action by the professional body for breaching the code.

Stakeholders' Interests:

- I will have sacrificed the interests of different stakeholders, including the company, the board, the shareholders and the investing public if I accept the offer and cover up Derek's act.
  - ***Company*** - If Derek's wife fails to secure new investment and cannot repay the loan, the restaurant group will suffer losses in its net asset value. The restaurant group's reputation will also be damaged if the whole incident, especially the Chairman's manipulation of company funds raised through the IPO and not disclosing relevant information to shareholders, becomes known to the public. Its share price will fall as a result.

- ***Shareholders and the investing public*** - They will suffer from financial losses if the restaurant group's share price plummets.
- ***Board*** - Credibility of the board will be affected as company directors failed to perform their monitoring role and safeguard the interests of the company and shareholders. The incident will adversely affect the reputation of individual board members to a certain extent.

7 Guide on Producing Simplified Listing Documents Relating to Equity Securities for New Applicants – I. "Use of Proceeds" Section, Guidance Letter HKEX-GL86-16, The Stock Exchange of Hong Kong Limited (the Exchange)

- The IPO applicant should include a detailed breakdown of the use of proceeds in its listing documents.
- Paragraph 3.13 states that any material change of use of proceeds is generally price sensitive and an IPO applicant must make an announcement to notify investors of the change after listing if such information was not previously disclosed in the listing document.

- The Letter can be downloaded from the following website:
  en-rules.hkex.com.hk/net_file_store/new_rulebooks/g/l/gl8616.pdf

Step 2

Perform the guardian role of a company director proactively through:

- Assessing the risk level involved in any strategy devised;
- Putting brakes on poor strategies or decisions, demanding management's explanations and rectifications; and
- Reporting to the board and the relevant authority any unethical concerns, conflicts of interest, malpractices or illegal acts unveiled.

Assessing the risk level brought about by Derek's illegal acts:

- Derek's secret pledge of the IPO funds to secure loans for his wife would increase the financial risks of the company and cause grave consequences to different stakeholders as mentioned above. As an INED and Chairman of the audit committee, I should inquire with Derek diligently and demand for an explanation once I observe the irregularities in the financial figures. I should seek professional advisors, the company secretary, financial controller or the internal auditor, for assistance in looking into the matter.

Monitoring the management to mitigate the risks:

- Weak management controls create opportunities for persons under financial, social or other pressure to exploit circumstances and rationalise their fraudulent actions.[3]
- I should ensure the management implements different control measures to limit opportunities for manipulation of company funds by any individual. Examples include requiring board approval for use of IPO funds or loans over a certain amount; monitoring the due checking of company funds by internal and external auditors; setting policy to govern non-audit services taken up by the serving audit firm; and enhancing the awareness of directors and in fact all levels of staff on related law and guidelines governing illegal acts, conflicts of interest or unethical behaviours.

[3] A criminologist, Donald Cressey, developed the fraud triangle model which suggests that a person may commit fraud when three elements (i.e. opportunity, pressure and rationalisation) coexist.

Determining if Derek has violated any laws or guidelines and making report:

- Derek violates the POBO by offering the golf trip to me as a reward for my keeping quiet about his pledge of the company funds. [1] page 11
- Derek also violates the Theft Ordinance for obtaining pecuniary advantage by deception through dishonestly and secretly pledging his company's IPO funds to secure a bank loan for his wife. [8] page 26
- If Derek fabricates a resolution purporting that the board has given consent on pledging the company's funds for the above purpose to deceive the bank, he may have committed other criminal offences, such as forgery.
- Derek may also breach fiduciary duties and duties of a director to exercise reasonable care, skill and diligence expected of a person of his knowledge and experience and holding his office in the company. He also fails to keep shareholders properly informed as required.
- The CO also contains provisions prohibiting loans and similar transactions in favour of directors and their connected persons. The general rule is that a company cannot make a loan to another company controlled by one of its directors or enter into any guarantee to provide any security in connection with a loan made by any person to such a company without prescribed approval of members. Derek's pledge of the IPO funds for a loan to his wife's company may render him liable under this Ordinance. [9] page 33
- After determining Derek's violation of laws and guidelines, I have to report the incident to my fellow board members and relevant law enforcement agencies and regulatory bodies. Otherwise, stakeholders will regard me as having tolerated misfeasance and illegal acts.
- I have to serve as a good role model to staff members of the restaurant group which, in turn, will discourage their unethical and illegal acts to a certain extent. This also presents a positive image as it shows the group takes ethics seriously which can attract further investment in the future.

Step 3

Sunshine test should always be applied while conducting board and corporate affairs to assess whether the issue can be discussed openly and the decision disclosed without misgivings.

- If the case is reported by the media, can I properly explain why I have not taken action against wrong-doing or why I was not aware of it as the Chairman of audit committee?
- Can I disclose my decision to any parties, including my fellow board members, management and staff members of the restaurant group, friends and family members, without misgivings?

After going through the above three steps, select an appropriate course of action that can maximise the important values and interests of all stakeholders. Make a commitment to the choice and implement it.

Section B Corporate Level

Company directors, as stewards of the corporation, should continuously monitor both financial and non-financial results of the corporation. As such, they are responsible for overseeing that the management team implements a sound and effective corporate ethics programme to safeguard interests of different stakeholders, particularly the shareholders' investment and the corporation's long-term viability. We provide below the **"Corporate Ethics Compass"** [11] as a practical tool for company directors to direct what the management should put in practice.

[11] **"Corporate Ethics Compass"**

Navigating the right course – ***Leadership***

Walking the talk – ***Code of Conduct***

Enhancing staff competence – ***Training***

Strengthening ***control systems*** *– Best Practices*

Navigating the right course – Leadership

Top management steers the daily operation of a company. Company directors should oversee whether they have taken the lead in establishing and sustaining a clean corporate culture. They should constantly demand that management serves as role model for their subordinates, openly communicates with staff members on a regular basis to collect feedback and urges them to speak freely when encountering any malpractices, corruption or crimes. This can facilitate exposure of and eradicate irregularities at an early stage before the matter worsens and undermines the entire company.

Walking the talk – Code of Conduct

An effective corporate code of conduct not only reduces incidents of corruption, fraud and conflicts of interest, but also enhances the trust and confidence of customers, suppliers, contractors, all who have business dealings with the enterprise and even investors.

An effective corporate code of conduct should increase staff morale and enhance staff integrity. Company directors should therefore ensure the management adheres to the following principles while formulating and implementing a code of conduct:

- **No double standards** – Core values and principles embodied in the code should be consistently applied. Double standards will cause confusion to staff.
- **Comprehensive coverage** – Follow the legal requirements and the company's own business practice while formulating the code. Some issues to cover include policy on accepting and offering advantages in relation to company business, guidelines on conflicts of interest and handling confidential information, channels for reporting misconduct and illegal acts [12] and disciplinary action against violation of the code. A sample corporate code of conduct [13] covering the above items is provided to facilitate a company to formulate a code of conduct.
- **Open consultation** – The process of formulating the code should be made open with wide consultation at all levels.
- **Good communication** – The code should be communicated to all parties concerned, both within and outside the company. Listed companies are required to disclose information on their policies on bribery according to the Environmental, Social and Governance Reporting Guide, Appendix 27 of the Listing Rules. [8]
- **Fair and square** – The code should be enforced under a transparent system of fair reward and punishment.
- **Constant review** – The code should be reviewed regularly to keep abreast of changes in business environment and changes imposed by the regulatory authorities.

The code of conduct should also apply to all directors and all levels of staff to manifest the corporation's emphasis on one common ethical standard. [3] page 20 *D.3.1 (d), Corporate Governance Code and Corporate Governance Report, Appendix 14 of the Listing Rules*

[12] Whistle blowing policy

A whistle blowing policy (which can be renamed as a policy on reporting of concerns to avoid any stigma in the title) should be included in the code of conduct. The following suggestions can enhance its effectiveness:

- Set up a user-friendly channel for staff to raise enquiries or lodge complaints;
- Deploy a senior officer reporting directly to the board, such as the audit committee, to ensure each complaint is handled independently;
- Publicise the above clearly and regularly to staff of all levels;
- Deal with each complaint expeditiously, diligently and confidentially;
- Take disciplinary action as necessary or refer cases of suspected corruption, fraud or other crimes to the regulatory authorities or law enforcement agencies; and
- Document every action taken properly.

[13] Sample Code of Conduct for Business Corporations

Please refer to **Annex 5**

[8] Environmental, Social and Governance Reporting Guide, Appendix 27 of the Listing Rules, The Stock Exchange of Hong Kong Limited (the Exchange)

- The Guide is appended to the Listing Rules [1] **page 13** and comprises two levels of disclosure obligations including "comply or explain" provisions and recommended disclosures on reporting environmental, social and governance issues.
- Listed companies are required under Aspect B7 (Anti-corruption) of the Guide to disclose information on the policies and the company's compliance with relevant laws and regulations that have a significant impact on the issuer relating to bribery, extortion, fraud and money laundering.
- Listed companies are recommended to disclose the number and outcomes of concluded legal cases regarding corrupt practices brought against the issuer or its employees; and preventive measures and whistle-blowing procedures implemented.
- The document can be downloaded from the following website:

www.hkex.com.hk/eng/rulesreg/listrules/mbrules/documents/appendix_27.pdf

Strengthening control systems – Best Practices

Various systems of operation, from sales and marketing on the front line to accounting and administration in the back office, are vital to most corporations. Imposing a tight control over these systems helps build up an alarm mechanism that is capable of detecting and responding to irregularities at an early stage. The management can then take measures to address the malpractices and violations.

Company directors should constantly question and monitor if the management has applied the following principles while implementing risk management and internal control systems:

Establish clear work procedures and responsibilities

A handbook or manual can be produced to detail the structure of the company, the chain of command, power and responsibilities of each division in the company and specific procedures of different functions. All instructions should be consistent and straightforward.

Ensure effective supervision

Top management should exercise tight supervision to ensure all rules and procedures are followed.

Maintain proper records and appropriate data management

Manuals can be drawn up to show staff members how to handle the business records, invoices, receipts and other relevant corporate documentation to ensure all records are accurate and up-to-date. Information management systems should be established and professionally managed to protect sensitive information.

Incorporate checks and balances

Incorporate various types of checks and balances into the system of control to prevent or detect irregularities and malpractices early. Examples include countersigning, random checking, periodic rotation of staff, internal and external audits and detecting early warning signs and red flags.

Conduct periodic reviews

Periodically review and improve different aspects of the risk management and internal control systems to ensure its effectiveness so as to minimise corruption loopholes.

Enhancing staff competence – Training

Even though a comprehensive code of conduct is developed and an elaborate system of controls established, staff members with a low standard of integrity may still bend the rules for personal gain. The fundamental means to cultivate an ethical corporate culture is to enhance staff competence through ethics training or other culture-building activities.

Company directors need to assure the management arranges ethics training or integrity programmes to preferably all levels of staff. This aims to achieve the following ultimate objectives:

- Enhancing staff's knowledge on legal and regulatory requirements;
- Enabling staff to understand the ethical standards set by the company and the management's determination to include ethics as an integral part of the business practice;
- Equipping staff with skills to handle ethical dilemmas encountered in workplace better; and
- Equipping staff at management level with skills to detect early warning signs of malpractices, develop measures to prevent unethical and illegal conducts and manage staff integrity properly.

Corporate Ethics Programme

To ensure sound implementation of the corporate ethics programme, company directors can consider setting up a committee, such as an ethics committee, to regularly review the management's scope and quality of efforts in putting the "**Corporate Ethics Compass"** into practice. They can also demand the management to report and explain any incidents of significant failings or weaknesses, impacts created on the corporation and the plan of rectification.

As mentioned in Part 3 under case 3.5 page 51 , the Community Relations Department of the ICAC has produced a health checklist [7] page 54 to help companies constantly assess if they have done enough to guard against corruption and other malpractices.

The Corruption Prevention Department of the ICAC has also produced the *Anti-Corruption Programme - A Guide for Listed Companies*. The Guide contains corruption prevention principles and practices which could help minimise the risk of corruption and malpractice in a company, and detect irregularities at an early stage.

To obtain a copy of the Guide, please refer to the contact details in Part 5 – Corruption Prevention Advisory Service (CPAS) page 85 or click the CPAS website at:

cpas.icac.hk

Part 5

ASSISTANCE

Supporting Partners within Reach

Part 5

ASSISTANCE

Supporting Partners within Reach

The ICAC, in particular its Hong Kong Business Ethics Development Centre, the related regulatory authorities, professional institutions and chambers of commerce all provide a wide range of services to company directors for helping them:

- Uphold a high standard of personal integrity;
- Enhance understanding on their roles and responsibilities, especially on the aspect of ethical governance;
- Address and monitor the risks facing fellow board members and the corporation as a whole; and
- Oversee the management in formulating a corporate ethics programme and put ethics management into practice.

Section A Assistance from the Hong Kong Business Ethics Development Centre and the ICAC

Consultancy services on corporate ethics programmes

The Hong Kong Ethics Development Centre was set up in 1995 under the auspices of the Community Relations Department of the ICAC. In May 2015, the Centre was rebranded as Hong Kong Business Ethics Development Centre to better reflect its scope of services. Tasked to promote business and professional ethics in Hong Kong as the first line of defence against corruption, the Centre offers a full range of free consultancy services on corporate ethics programme. Its services include:

- Formulating and reviewing codes of conduct and offering advice on how to implement the code effectively;
- Organising ethics training courses and integrity projects for various levels of staff. Courses range from explaining the anti-corruption law to providing measures to manage staff integrity and skills to handle ethical dilemmas at work;
- Setting up and reviewing system controls to plug corruption loopholes in different functional areas;
- Offering practical guides and training packages on ethics management for various trades or professions; and
- Operating a resource centre and a website on ethics-related reference materials.

Enhancing ethical governance for company directors

The Centre also jointly organises ethics training with related regulators and professional bodies to promote directors' ethics in a structured and systematic way. Company directors can:

- Attend thematic workshops and seminars to examine the ethical challenges facing them and share experiences with fellow directors and senior corporate management on how to tackle these challenges;
- Get practical tools and handy references like this Toolkit to facilitate them practise ethical governance; and
- Obtain tailor-made corruption prevention services whenever in need.

For enquiries or further information, please contact the Centre through the following channels:

By mail:	8/F, 303 Java Road, North Point, Hong Kong
By phone:	2587 9812
By fax:	2519 7762
By e-mail :	hkbedc@crd.icac.org.hk
Through website :	www.hkbedc.icac.hk

You may also contact any ICAC Regional Office for assistance. Annex 6 *Contact Information*

Corruption prevention advisory services

Under the Corruption Prevention Department of the ICAC, the Corruption Prevention Advisory Service offers private organisations expert advice on how to tighten up internal controls to minimise opportunities for corruption and malpractice.

For further information, please contact the Corruption Prevention Advisory Service through the following channels:

By phone:	2526 6363
By fax:	2522 0505
By e-mail:	cpas@cpd.icac.org.hk
Through website:	cpas.icac.hk

Corruption reporting and enquiry services

The Operations Department of the ICAC is responsible for investigating corruption complaints in strict confidence. You can lodge a report or make an enquiry through the following channels:

By phone:	25 266 366 (24-hour service)
In person:	ICAC Report Centre (24-hour service) 303 Java Road, North Point, Hong Kong Or ICAC Regional Offices Annex 6 *Contact Information* (Service hours: Mon – Fri, 9am – 7pm; except public holidays)
By mail:	The ICAC, GPO Box 1000, Hong Kong

Section B Assistance from Government Departments, Regulatory Bodies, Professional Bodies and Chambers of Commerce

Apart from the ICAC, a number of government departments, regulatory bodies, professional associations and chambers of commerce have endeavoured to promote directors' ethics and good corporate governance to the business sector in Hong Kong. Some of them offer training programmes on corporate governance and roles of company directors, senior management and professional advisors and / or produce publications on related topics for them. Details can be found on their websites as follows:

Government Departments / Regulatory Bodies

Companies Registry

www.cr.gov.hk

Official Receiver's Office

www.oro.gov.hk

Hong Kong Exchanges and Clearing Limited

www.hkex.com.hk

Securities and Futures Commission

www.sfc.hk

Professional Bodies

Hong Kong Institute of Certified Public Accountants
www.hkicpa.org.hk

The Hong Kong Institute of Chartered Secretaries
www.hkics.org.hk

The Hong Kong Institute of Directors
www.hkiod.com

The Law Society of Hong Kong
www.hklawsoc.org.hk

Chambers of Commerce (Member Chambers of The Hong Kong Business Ethics Development Advisory Committee)

Federation of Hong Kong Industries
www.industryhk.org

The American Chamber of Commerce in Hong Kong
www.amcham.org.hk

The Chinese General Chamber of Commerce
www.cgcc.org.hk

The Chinese Manufacturers' Association of Hong Kong
www.cma.org.hk

The Hong Kong Chinese Enterprises Association

www.hkcea.com

The Hong Kong General Chamber of Commerce

www.chamber.org.hk

The British Chamber of Commerce in Hong Kong

www.britcham.com

The European Chamber of Commerce in Hong Kong

www.eurocham.com.hk

The Hong Kong Japanese Chamber of Commerce & Industry

www.hkjcci.com.hk/en_index.aspx

The Indian Chamber of Commerce Hong Kong

www.icchk.org.hk

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Annexes

Annex 1

Extracts from the Prevention of Bribery Ordinance (Laws of Hong Kong Cap. 201)

Section 9 Corrupt transactions with agents

(1) Any agent who, without lawful authority or reasonable excuse, solicits or accepts any advantage as an inducement to or reward for or otherwise on account of his-

(a) doing or forbearing to do, or having done or forborne to do, any act in relation to his principal's affairs or business; or

(b) showing or forbearing to show, or having shown or forborne to show, favour or disfavour to any person in relation to his principal's affairs or business,

shall be guilty of an offence.

(2) Any person who, without lawful authority or reasonable excuse, offers any advantage to any agent as an inducement to or reward for or otherwise on account of the agent's-

(a) doing or forbearing to do, or having done or forborne to do, any act in relation to his principal's affairs or business; or

(b) showing or forbearing to show, or having shown or forborne to show, favour or disfavour to any person in relation to his principal's affairs or business,

shall be guilty of an offence.

(3) Any agent who, with intent to deceive his principal, uses any receipt, account or other document-

(a) in respect of which the principal is interested; and

(b) which contains any statement which is false or erroneous or defective in any material particular; and

(c) which to his knowledge is intended to mislead the principal,

shall be guilty of an offence.

(4) If an agent solicits or accepts an advantage with the permission of his principal, being permission which complies with subsection (5), neither he nor the person who offered the advantage shall be guilty of an offence under subsection (1) or (2).

(5) For the purposes of subsection (4) permission shall-

(a) be given before the advantage is offered, solicited or accepted; or

(b) in any case where an advantage has been offered or accepted without prior permission, be applied for and given as soon as reasonably possible after such offer or acceptance,

and for such permission to be effective for the purposes of subsection (4), the principal shall, before giving such permission, have regard to the circumstances in which it is sought.

Section 11 Giver and acceptor of bribe to be guilty notwithstanding that purpose not carried out, etc.

(1) If, in any proceedings for an offence under any section in this Part, it is proved that the accused accepted any advantage, believing or suspecting or having grounds to believe or suspect that the advantage was given as an inducement to or reward for or otherwise on account of his doing or forbearing to do, or having done or forborne to do, any act referred to in that section, it shall be no defence that–

(a) he did not actually have the power, right or opportunity so to do or forbear;

(b) he accepted the advantage without intending so to do or forbear; or

(c) he did not in fact so do or forbear.

(2) If, in any proceedings for an offence under any section in this Part, it is proved that the accused offered any advantage to any other person as an inducement to or reward for or otherwise on account of that other person's doing or forbearing to do, or having done or forborne to do, any act referred to in that section, believing or suspecting or having reason to believe or suspect that such other person had the power, right or opportunity so to do or forbear, it shall be no defence that such other person had no such power, right or opportunity.

Section 19 Custom not to be a defence

In any proceedings for an offence under this Ordinance, it shall not be a defence to show that any such advantage as is mentioned in this Ordinance is customary in any profession, trade, vocation or calling.

Section 2 Interpretation

'Advantage' means-

(a) any gift, loan, fee, reward or commission consisting of money or of any valuable security or of other property or interest in property of any description;

(b) any office, employment or contract;

(c) any payment, release, discharge or liquidation of any loan, obligation or other liability, whether in whole or in part;

(d) any other service, or favour (other than entertainment), including protection from any penalty or disability incurred or apprehended or from any action or proceedings of a disciplinary, civil or criminal nature, whether or not already instituted;

(e) the exercise or forbearance from the exercise of any right or any power or duty; and

(f) any offer, undertaking or promise, whether conditional or unconditional, of any advantage within the meaning of any of the preceding paragraphs (a), (b), (c), (d) and (e),

but does not include an election donation within the meaning of the Elections (Corrupt and Illegal Conduct) Ordinance (Cap. 554), particulars of which are included in an election return in accordance with that Ordinance.

'Entertainment' means the provision of food or drink, for consumption on the occasion when it is provided, and of any other entertainment connected with, or provided at the same time as, such provisions.

Annex 2

Ethics Checklist for Company Directors

As a prospective company director, what areas of concern do you have to consider before accepting the offer as a member of the corporation's navigating team? After entering the board, what measures and actions do you have to take to ensure effective performance of your monitoring role? A self-questioning tool, an ethics checklist, is prepared below for your assessment before and after joining the board. After going through the following questions, you should be in a better position to:

- determine if the corporation is a suitable choice for you; and
- assess the sufficiency and effectiveness of how you fulfil your monitoring and supervision role.

Getting Started - Are you ready for the mission?

About the Company

- What is the scope of business of the company?
- What is the company's organisation structure? What are its major subsidiaries and associated companies? What is the nature and scale of their businesses?
- Where are the major operations of the company and / or its subsidiaries / associated companies? What is the business and legal environment there? Is there widespread corruption?
- What is the company's financial structure? Is the financial position of the company clearly and properly disclosed?
- What are the major strengths and weaknesses (including business risks) of the company? What are possible opportunities and threats for the company?

About the Board

- What is the share options structure? Who is / are the major shareholder(s)? How about his / their level of integrity and investment style?
- How is the board's relationship with shareholders and other stakeholders?
- Who is the Chairman? Is his role clearly divided from the Chief Executive Officer? How is his reputation (including level of integrity) and style of chairmanship?
- Who are other executive and non-executive directors (including independent ones)? What is their reputation (including level of integrity) and style of directorship? How many directorships do they hold?
- Does the board have the right mix of experience and skill?

- What kinds of committees are set up under the board? Are they led by members with relevant experience and skill?
- Is there a designated person taking up the role of company secretary? How is his job-related experience and reputation (including level of integrity)?

About the Management

- Who comprises the management team? What is their reputation (including level of integrity) and management style?
- Is there high turnover among the management and senior staff? If yes, what are the reasons for frequent changes of members?
- Who is the Chief Financial Controller? What is his job-related experience and reputation (including level of integrity)?
- Who is the company's external auditor? Is it engaged to provide the company with other non-audit services? What is the ratio of audit fees as compared with those for non-audit services?

About the Corporate Governance Framework

- What is the board's and management's attitude towards corporate governance practices? Does the board and the management approach the matter in a formulaic manner? Or are they genuinely trying to become more transparent and accountable?
- What efforts have the board and management made in complying with or raising the corporate governance standard (e.g. in accordance with the provisions and best practices laid down in the Corporate Governance Code and Corporate Governance Report contained in Appendix 14 of the Listing Rules, formulation of policies, implementation of risk management and internal control systems, arrangement of training, etc.)?

About Yourself

- Is the role you are being asked to perform clear?
- What committee(s), if any, will you be expected to sit on and how often will they meet?
- What level of induction to the company is being offered? Does the company have an induction programme? Does the induction programme adequately acquaint you with the company's business operations?
- How will you fit into the board structure and what will you add?

- Does the company's value and mission match with your own value?
- How many directorships are you holding at present?
- Can you invest sufficient time and energy to take up the new directorship?

Joining the Board – Can you perform the duty effectively?

As Non-executive Director:

- Can you make independent judgement in the board meetings, especially on issues of accountability and standards of conduct?
- Can you contribute by serving on committees, such as audit, remuneration, nomination, ethics and / or other corporate governance committees?
- Can you monitor the performance of the company to ensure it meets its corporate goals and ethical standards?
- Can you provide independent, constructive and informed comments to the development of the company's business strategy and ethics policy?
- Can you advise the board and / or the committees based on your skills, professional knowledge and experience?

As Chairman:

- Can you ensure all directors are properly briefed on the issues arising at the board meetings?
- Can you provide leadership in discussing ethical issues faced by the company?
- Do you take up responsibility for ensuring good corporate governance practices and procedures are established?
- Do you encourage all directors to fully participate in and contribute to the board and act in the interest of the company?

As All Other Directors:

- Do you demonstrate willingness and readiness to devote time and effort to the company?
- Do you actively participate in the board meetings and make ethical decisions for the benefits of the company and its shareholders?
- Do you recognise your responsibilities to comply with the Code of Ethics and declare conflicts of interest?

Developed by the Hong Kong Business Ethics Development Centre, ICAC

Annex 3

Health Checklist on Corporate Ethics Programme

Setting One Common Standard - Company Code of Conduct

	Yes	No
Does my company have a code of conduct to provide guidelines on ethical standards for all directors and employees?	◯	◯
Does the code cover the areas below for members of the Board of Directors and staff to follow?		
• Solicitation and acceptance of gifts and other advantages, including the restrictions on the circumstances and financial limits	◯	◯
• Offering of advantages to others to obtain business or for the purpose of influencing others in business dealings	◯	◯
• Acceptance of entertainment	◯	◯
• Observing laws, regulations and guidelines set out by relevant regulators and professional bodies	◯	◯
• Observing local laws when working in other jurisdictions	◯	◯
• Declaration of conflicts of interest	◯	◯
• Handling of confidential information and company property	◯	◯
• Relationship with suppliers and contractors	◯	◯
• Relationship with public officials	◯	◯
• Channels for enquiries and complaints	◯	◯
• Consequences for violating the code	◯	◯
Is there a designated officer with appropriate level of authority to deal with reports on advantages received, conflict of interest declarations and other matters relating to the implementation of the code?	◯	◯
If yes, title of the designated officer : _____		
Is his / her rank appropriate?	◯	◯
Is there a mechanism to constantly remind directors and staff of the contents of the code?	◯	◯
Do other stakeholders including suppliers, contractors and business partners have a good understanding of the code, especially the policy on acceptance of gifts, other advantages and entertainment?	◯	◯
Is the code regularly reviewed to meet the current and future needs of the company?	◯	◯
If yes, when was the last review conducted : _____		
➠ **Is it opportune to review the code now?**	◯	◯

Cultivating Ethical Mind - Corporate Training and Integrity Projects

Does my company use the following channels to communicate corporate values and ethics management to directors and employees?	Yes	No
• Induction programmes for newly recruited staff on their legal obligations and our company code	○	○
• Ethics or compliance training :		
• for directors on ethics management and their responsibilities	○	○
• for managerial staff on their role of managing staff integrity, assessing the risks and preventing corruption in the workplace	○	○
• for frontline staff on the common corruption pitfalls and the skills to handle ethical dilemmas at work	○	○
• Internal communication channels, e.g. circulars, newsletters, posters, intranet, etc.	○	○
• Staff integrity projects, e.g. exhibition, quiz, various competitions, etc.	○	○
• Other training courses / channels: (please specify) _____	○	○
➠ **Is it opportune to arrange the training courses now?**	○	○

Plugging the Loopholes - System Controls

Does my company adopt system controls (e.g. operational guidelines, procedures, control mechanisms, regular internal audits, etc.) in the following functional areas?	Yes	No
• Procurement	○	○
• Contract Management	○	○
• Sales and Marketing	○	○
• Finance and Accounting	○	○
• Human Resources Management and Administration	○	○
• Inventory and Stock Control	○	○
• Others: (please specify) _____	○	○
Do system controls for the above functional areas align with my company's corporate ethics principles (e.g. emphasising integrity and capabilities in recruitment and staff promotion, setting realistic marketing goals, etc.)?	○	○
Are the policies and operational manuals / procedures / guidelines regularly reviewed?	○	○
If yes, when was the last review conducted : _____		
➠ **Is it opportune to review these system controls now?**	○	○

Source: The Hong Kong Business Ethics Development Centre, ICAC

Annex 4

Sample Performance Evaluation for the Board and Individual Board Members

This performance evaluation comprises two parts:
Part 1: Evaluation of the board as a group
Part 2: Evaluation of individual board member

All members of the board are required to complete Part 1 of this performance evaluation, whereas separate forms should be used for each board member appraised in Part 2.

Part 1: Evaluation of the board as a group

Please indicate your view as to the following statements by circling the appropriate number on a scale of 1-5 (where 1=strongly disagree and 5=strongly agree). You are also welcome to give specific comments to each statement if deemed appropriate.

	Strongly Disagree				Strongly Agree
1. The board knows and understands the company's visions, business values, strategic precepts and operating plan. Comments:_____	1	2	3	4	5
2. The board reflects its understanding of the company's vision, business values, strategic precepts and operating plan in its discussions and actions on key issues throughout the year. Comments:_____	1	2	3	4	5
3. The board reviews and adopts a Code of Ethics for Directors. Comments:_____	1	2	3	4	5
4. The board encourages open communication and active participation; and gives timely response and resolution to key business issues. Comments:_____	1	2	3	4	5

	Strongly Disagree				Strongly Agree
5. The board conducts informed and meaningful discussions with the right kind of information and materials available to members sufficiently in advance of the meetings. Comments:_____	1	2	3	4	5
6. The board members are diligent in preparing for the meetings. Comments:_____	1	2	3	4	5
7. The board reviews and adopts an annual operating plan and regularly monitors the company's performance against the plan throughout the year. Comments:_____	1	2	3	4	5
8. The board and / or the audit committee regularly monitors the company's annual budget, financial statements, balance sheets and cash flow. Comments:_____	1	2	3	4	5
9. The board regularly arranges formal and tailored professional training to update members of the latest business and regulatory developments in the market. Comments:_____	1	2	3	4	5
10. The board regularly considers the performance of peer companies in evaluating the performance of its own. Comments:_____	1	2	3	4	5
11. The board regularly reviews the performance and ethics of the CEO. Comments:_____	1	2	3	4	5
12. The board regularly reviews the performance and ethics of other senior executives. Comments:_____	1	2	3	4	5

	Strongly Disagree				Strongly Agree
13. The board and / or the remuneration committee ensures that the remuneration packages of the senior executives are commensurate with the company and individual performances. Comments:_____	1	2	3	4	5
14. The board reviews the succession plans for the CEO and senior executives. Comments:_____	1	2	3	4	5
15. The board has established sufficient and relevant committees to monitor different key issues of the board. Comments:_____	1	2	3	4	5
16. The trigger point for key issues to be reported to the whole board is sufficient. Comments:_____	1	2	3	4	5
17. The trigger level for the board or committee involvement in important business policies and decisions is appropriate. Comments:_____	1	2	3	4	5

Part 2: Evaluation of individual board member

(This part should be conducted in confidence.)

Name of the appraising board member:

_____

Name of the board member appraised:

_____

Please indicate your view as to the following statements by circling the appropriate number on a scale of 1-5 (where 1=strongly disagree and 5=strongly agree). You are also welcome to give specific comments to each statement if deemed appropriate.

	Strongly Disagree				Strongly Agree
1. He / She has a good knowledge of the business, its organisation and culture. Comments:_____	1	2	3	4	5
2. He / She has a good insight into the business in which our company is active. Comments:_____	1	2	3	4	5
3. He / She is well informed on current economic / political / social issues in our main market(s). Comments:_____	1	2	3	4	5
4. He / She consistently displays a solid commitment to the role of a board member (e.g. is well prepared for board meetings, invests sufficient time and energy in the board affairs, raises appropriate questions). Comments:_____	1	2	3	4	5
5. He / She uses his / her knowledge, expertise and experience to give the board and management new impulses (contributes a creative and practical perspective to the work of the board). Comments:_____	1	2	3	4	5
6. He / She expresses concerns and opinions honestly and in the best interest of the company. Comments:_____	1	2	3	4	5
7. He / She shows ethics in handling affairs of the board and the corporation. Comments:_____	1	2	3	4	5
8. His / Her participation on the board enhances team development and team performance. Comments:_____	1	2	3	4	5

	Strongly Disagree				Strongly Agree
9. He / She listens to others' views.	1	2	3	4	5
Comments:_____					
10. He / She gets to the heart of issues in discussions.	1	2	3	4	5
Comments:_____					
11. His / Her participation in the board is not affected by conflicts of interest considerations.	1	2	3	4	5
Comments:_____					
12. His / Her contribution to the discussions enhances the quality of decisions made by the board. Contributions are constructive, practical and helpful.	1	2	3	4	5
Comments:_____					
13. He / She helps to manage conflict or disagreement constructively.	1	2	3	4	5
Comments:_____					
14. He / She stands up for own views against pressure from others.	1	2	3	4	5
Comments:_____					
15. In general, he / she displays persistently solid and ethical judgement.	1	2	3	4	5
Comments:_____					
16. In general, he / she displays genuine engagement with respect to his / her role as board member (attitude – willing "to go the extra mile"; regular attendance – not too many other board seats; etc).	1	2	3	4	5
Comments:_____					

Adapted from Mastering Global Corporate Governance, pages 127 - 133

Annex 5

Sample Code of Conduct for Business Corporations

ETHICAL COMMITMENT

1. The (name of company) (hereafter referred to as the Company) regards honesty, integrity and fair play as our core values that must be upheld by all directors and staff[1] of the Company at all times. This Code sets out the basic standard of conduct expected of all directors and staff, and the Company's policy on acceptance of advantage and handling of conflict of interest when dealing with the Company's business.

PREVENTION OF BRIBERY

2. The Company prohibits all forms of bribery and corruption. All directors and staff are prohibited from soliciting, accepting or offering any bribe in conducting the Company's business or affairs, whether in Hong Kong or elsewhere. In conducting all business or affairs of the Company, they must comply with the Prevention of Bribery Ordinance (POBO) of Hong Kong and must not:

   (a) solicit or accept any advantage from others as a reward for or inducement to doing any act or showing favour in relation to the Company's business or affairs, or offer any advantage to an agent of another as a reward for or inducement to doing any act or showing favour in relation to his principal's business or affairs;

   (b) offer any advantage to any public servant (incl. Government / public body employee) as a reward for or inducement to his performing any act in his official capacity or his showing any favour or providing any assistance in business dealing with the Government / a public body; or

   (c) offer any advantage to any staff of a Government department or public body while they are having business dealing with the latter.

   (The relevant provisions of the POBO are at Appendix 1.)

Acceptance of Advantage

3. It is the Company's policy that directors and staff should not solicit or accept any advantage for themselves or others, from any person, company or organisation having business dealings with the Company or any subordinate, except that they may accept (but not solicit) the following when offered on a voluntary basis:

---

[1] "Staff" cover full-time, part-time and temporary staff, except where specified.

(a) advertising or promotional gifts or souvenirs of a nominal value; or

(b) gifts given on festive or special occasions subject to a maximum limit of $____ in value; or

(c) discounts or other special offers given by any person or company to them as customers, on terms and conditions equally applicable to other customers in general.

4. Gifts or souvenirs described in paragraph 3(a) that are presented to directors and staff in official functions are deemed as offers to the Company. The directors and staff concerned should report the acceptance to the Company and seek direction as to how to handle the gifts or souvenirs from *the approving authority*[2] using Form A (Appendix 2). If a director or staff member wishes to accept any advantage not covered in paragraph 3, he / she should also seek permission from *the approving authority* using Form A.

5. However, a director or staff member should decline an offer of advantage if acceptance could affect his / her objectivity in conducting the Company's business or induce him / her to act against the interest of the Company, or acceptance will likely lead to perception or allegation of impropriety.

6. If a director or staff member has to act on behalf of a client in the course of carrying out the Company's business, he / she should also comply with any additional restrictions on acceptance of advantage that may be set by the client (e.g. directors and staff members performing any duties under a government or public body contract will normally be prohibited from accepting advantages in relation to that contract).

Offer of Advantage

7. Directors and staff are prohibited from offering advantages to any director, staff member or agent of another company or organisation, for the purpose of influencing such person in any dealing, or any public official, whether directly or indirectly through a third party, when conducting the Company's business. Even when an offer of advantage carries no intention of improper influence, it should be ascertained that the intended recipient is permitted by his employer / principal to accept it under the relevant circumstance before the advantage is offered.

[2] Specify the post of the approving authority in the Code and the Form.

Entertainment

8. Although entertainment[3] is an acceptable form of business and social behaviour, a director or staff member should avoid accepting lavish or frequent entertainment from persons with whom the Company has business dealing (e.g. suppliers or contractors) or from his / her subordinates to avoid placing himself / herself in a position of obligation.

Records, Accounts and Other Documents

9. Directors and staff should ensure that all records, receipts, accounts or other documents they submit to the Company give a true representation of the facts, events or business transactions as shown in the documents. Intentional use of documents containing false information to deceive or mislead the Company, regardless of whether there is any gain or advantage involved, may constitute an offence under the POBO.

COMPLIANCE WITH LAWS OF HONG KONG AND IN OTHER JURISDICTIONS

10. Directors or staff must comply with all local laws and regulations when conducting the Company's business, and also those in other jurisdictions when conducting business there[4] or where applicable[5].

CONFLICTS OF INTEREST

11. Directors and staff should avoid any conflict of interest situation (i.e. situation where their private interest conflicts with the interest of the Company) or the perception of such conflicts. When actual or potential conflict of interest arises, the director or staff member should make a declaration to *the approving authority* through the reporting channel using Form B (Appendix 3).

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[3] According to the POBO, "entertainment" means the provision of food or drink, for consumption on the occasion when it is provided, and of any other entertainment connected with or provided at the same time as the provision of food or drink.

[4] The 'Business Success: Integrity & Legal Compliance' – Corruption Prevention Guide for SMEs in Guangdong, Hong Kong and Macao jointly published by the ICAC, the Guangdong Provincial People's Procuratorate and the Commission Against Corruption of Macao provides guidance on the anti-bribery laws in Hong Kong, Mainland China and Macao. Directors and staff conducting the Company's business there may find it helpful.

[5] Some other countries' anti-bribery laws have provisions with extra-territorial effect, e.g. the UK's Bribery Act 2010, the USA's Foreign Corrupt Practices Act.

12. Some common examples of conflicts of interest are described below but they are by no means exhaustive:

    (a) A staff member involved in a procurement exercise is closely related to or has financial interest in the business of a supplier who is being considered for selection by the Company.

    (b) One of the candidates under consideration in a recruitment or promotion exercise is a family member, a relative or a close personal friend of the staff member involved in the process.

    (c) A director of the Company has financial interest in a company whose quotation or tender is under consideration by the Board.

    (d) A staff member (full-time or part-time) undertaking part-time work with a contractor whom he is responsible for monitoring.

MISUSE OF OFFICIAL POSITION, COMPANY ASSETS AND INFORMATION

13. Directors and staff must not misuse their official position in the Company to pursue their own private interests, which include both financial and personal interests and those of their family members, relatives or close personal friends.

14. Directors and staff in charge of or having access to any Company assets, including funds, property, information, and intellectual property, should use them solely for the purpose of conducting the Company's business. Unauthorised use, such as misuse for personal interest, is strictly prohibited.

15. Directors and staff should not disclose any classified information of the Company without authorisation or misuse any Company information (e.g. unauthorised sale of the information). Those who have access to or are in control of such information, including information in the Company's computer system, should protect the information from unauthorised disclosure or misuse. Special care should also be taken in the use of any personal data, including directors', staff's and customers' personal data, to ensure compliance with Hong Kong's Personal Data (Privacy) Ordinance.

OUTSIDE EMPLOYMENT

16. If a staff member wishes to take up employment outside the Company, he must seek the prior written approval of *the approving authority. The approving authority* should consider whether the outside employment would give rise to a conflict of interest with the staff member's duties in the Company or the interest of the Company.

RELATIONSHIP WITH SUPPLIERS, CONTRACTORS AND CUSTOMERS

Gambling

17. Directors and staff are advised not to engage in frequent gambling activities, (e.g. mahjong), with persons having business dealings with the Company.

Loans

18. Directors and staff should not accept any loan from, or through the assistance of, any individual or organisation having business dealings with the Company. There is, however, no restriction on borrowing from licensed banks or financial institutions.

[The Company may wish to include other guidelines on the conduct required of directors and staff in their dealings with suppliers, contractors, customers, and other business partners as appropriate to specific trades.]

COMPLIANCE WITH THE CODE

19. It is the responsibility of every director and staff member of the Company to understand and comply with this Code, whether performing his duties of the Company in or outside Hong Kong. Managers and supervisors should also ensure that the staff under their supervision understand well and comply with this Code.

20. Any director or staff member in breach of the Code will be subject to disciplinary action, including termination of appointment. Any enquiries about this Code or reports of possible breaches of this Code should be made to (*post of a designated senior staff member*). In case of suspected corruption or other criminal offences, a report should be made to the appropriate authority.

_____

(Name of Company)

Date :

Source: ICAC

Appendix 1 Extracts from the Prevention of Bribery Ordinance (Laws of Hong Kong Cap. 201)

Section 9

(1) Any agent who, without lawful authority or reasonable excuse, solicits or accepts any advantage as an inducement to or reward for or otherwise on account of his-

(a) doing or forbearing to do, or having done or forborne to do, any act in relation to his principal's affairs or business; or

(b) showing or forbearing to show, or having shown or forborne to show, favour or disfavour to any person in relation to his principal's affairs or business,

shall be guilty of an offence.

(2) Any person who, without lawful authority or reasonable excuse, offers any advantage to any agent as an inducement to or reward for or otherwise on account of the agent's-

(a) doing or forbearing to do, or having done or forborne to do, any act in relation to his principal's affairs or business; or

(b) showing or forbearing to show, or having shown or forborne to show, favour or disfavour to any person in relation to his principal's affairs or business,

shall be guilty of an offence.

(3) Any agent who, with intent to deceive his principal, uses any receipt, account or other document-

(a) in respect of which the principal is interested; and

(b) which contains any statement which is false or erroneous or defective in any material particular; and

(c) which to his knowledge is intended to mislead the principal,

shall be guilty of an offence.

(4) If an agent solicits or accepts an advantage with the permission of his principal, being permission which complies with subsection (5), neither he nor the person who offered the advantage shall be guilty of an offence under subsection (1) or (2).

(5) For the purposes of subsection (4) permission shall-

(a) be given before the advantage is offered, solicited or accepted; or

(b) in any case where an advantage has been offered or accepted without prior permission, be applied for and given as soon as reasonably possible after such offer or acceptance,

and for such permission to be effective for the purposes of subsection (4), the principal shall, before giving such permission, have regard to the circumstances in which it is sought.

Section 4

(1) Any person who, whether in Hong Kong or elsewhere, without lawful authority or reasonable excuse, offers any advantage to a public servant as an inducement to or reward for or otherwise on account of that public servant's-

(a) performing or abstaining from performing, or having performed or abstained from performing, any act in his capacity as a public servant;

(b) expediting, delaying, hindering or preventing, or having expedited, delayed, hindered or prevented, the performance of an act, whether by that public servant or by any other public servant in his or that other public servant's capacity as a public servant; or

(c) assisting, favouring, hindering or delaying, or having assisted, favoured, hindered or delayed, any person in the transaction of any business with a public body,

shall be guilty of an offence.

(3) If a public servant other than a prescribed officer solicits or accepts an advantage with the permission of the public body of which he is an employee being permission which complies with subsection (4), neither he nor the person who offered the advantage shall be guilty of an offence under this section.

(4) For the purposes of subsection (3) permission shall be in writing and-

(a) be given before the advantage is offered, solicited or accepted; or

(b) in any case where an advantage has been offered or accepted without prior permission, be applied for and given as soon as reasonably possible after such offer or acceptance,

and for such permission to be effective for the purposes of subsection (3), the public body shall, before giving such permission, have regard to the circumstances in which it is sought.

Section 8

(1) Any person who, without lawful authority or reasonable excuse, while having dealings of any kind with the Government through any department, office or establishment of the Government, offers any advantage to any prescribed officer employed in that department, office or establishment of the Government, shall be guilty of an offence.

(2) Any person who, without lawful authority or reasonable excuse, while having dealings of any kind with any other public body, offers any advantage to any public servant employed by that public body, shall be guilty of an offence.

Section 2

'Advantage' means-

(a) any gift, loan, fee, reward or commission consisting of money or of any valuable security or of other property or interest in property of any description;

(b) any office, employment or contract;

(c) any payment, release, discharge or liquidation of any loan, obligation or other liability, whether in whole or in part;

(d) any other service, or favour (other than entertainment), including protection from any penalty or disability incurred or apprehended or from any action or proceedings of a disciplinary, civil or criminal nature, whether or not already instituted;

(e) the exercise or forbearance from the exercise of any right or any power or duty; and

(f) any offer, undertaking or promise, whether conditional or unconditional, of any advantage within the meaning of any of the preceding paragraphs (a), (b), (c), (d) and (e),

but does not include an election donation within the meaning of the Elections (Corrupt and Illegal Conduct) Ordinance (Cap. 554), particulars of which are included in an election return in accordance with that Ordinance.

'Entertainment' means-

The provision of food or drink, for consumption on the occasion when it is provided, and of any other entertainment connected with, or provided at the same time as, such provisions.

Section 11

(1) If, in any proceedings for an offence under any section in this Part, it is proved that the accused accepted any advantage, believing or suspecting or having grounds to believe or suspect that the advantage was given as an inducement to or reward for or otherwise on account of his doing or forbearing to do, or having done or forborne to do, any act referred to in that section, it shall be no defence that-

(a) he did not actually have the power, right or opportunity so to do or forbear;

(b) he accepted the advantage without intending so to do or forbear; or

(c) he did not in fact so do or forbear.

(2) If, in any proceedings for an offence under any section in this Part, it is proved that the accused offered any advantage to any other person as an inducement to or reward for or otherwise on account of that other person's doing or forbearing to do, or having done or forborne to do, any act referred to in that section, believing or suspecting or having reason to believe or suspect that such other person had the power, right or opportunity so to do or forbear, it shall be no defence that such other person had no such power, right or opportunity.

Section 19

In any proceedings for an offence under this Ordinance, it shall not be a defence to show that any such advantage as is mentioned in this Ordinance is customary in any profession, trade, vocation or calling.

FORM A

Appendix 2
(Company Name)
REPORT ON GIFTS / ADVANTAGES RECEIVED

Part A – Declaration *(To be completed by Receiving Staff)*

To : (Approving Authority)

Description of Offeror : *Name & title :* *Company :* *Relationship (business / personal) :*	 _____ _____ _____
Occasion on which the Gift / Advantage was / is to be received :	
Description & (assessed) value of the Gift / Advantage :	

Suggested Method of Disposal :	**Remark :**
( ) Retain by the receiving staff	
( ) Retain for display / as a souvenir in the office	
( ) Share among the office	
( ) Reserve as lucky draw prize at staff function	
( ) Donate to a charitable organisation	
( ) Return to offeror	
( ) Others (please specify) :	

_____ _____

(Date) (Name of Receiving Staff)
(Title / Department)

Part B – Acknowledgement *(To be completed by Approving Authority)*

To : (Name of Receiving Staff)

The recommended method of disposal is ****approved / not approved***.

*The Gift / Advantage concerned should be disposed of by way of : _____

_____

_____ _____

(Date) (Name of Approving Authority)
(Title / Department)

** Delete as appropriate*

FORM B

Appendix 3
(Company Name)
DECLARATION OF CONFLICTS OF INTEREST

Part A – Declaration *(To be completed by Declaring Staff)*

To : (Approving Authority) via (supervisor of the Declaring Staff)

I would like to report the following ****actual / potential*** conflicts of interest situation arising during the discharge of my official duties :-

Persons / companies with whom / which I have official dealings
My relationship with the persons / companies (e.g. relative)
Relationship of the persons / companies with our Company (e.g. supplier)
Brief description of my duties which involve the persons / companies (e.g. handling of tender exercise)

_____ _____

(Date) (Name of Declaring Staff)
(Title / Department)

Part B – Acknowledgement *(To be completed by Approving Authority)*

To : (Declaring Staff) via (supervisor of the Declaring Staff)

Acknowledgement of Declaration

The information contained in your declaration form of ____(Date)____ is noted. It has been decided that :-

☐ You should refrain from performing or getting involved in performing the work, as described in Part A, which may give rise to a conflict.

☐ You may continue to handle the work as described in Part A, provided that there is no change in the information declared above, and you must uphold the Company's interest without being influenced by your private interest.

☐ Others (please specify) :_____

_____

_____ _____

(Date) (Name of Approving Authority)
(Title / Department)

** Delete as appropriate*

Annex 6

Contact Information of the Hong Kong Business Ethics Development Centre and ICAC Regional Offices

Hong Kong Business Ethics Development Centre

Address: 8/F, 303 Java Road, North Point, Hong Kong
Tel: 2587 9812
Fax: 2519 7762
E-mail: hkbedc@crd.icac.org.hk
Website: www.hkbedc.icac.hk

ICAC Regional Offices

Please go to the ICAC website for the details of ICAC Regional Offices:
www.icac.org.hk/en/crd/struct/ro/index.html